83 - 1686
No.

In The

Supreme Court of the United States

October Term, 1983

In Re:

EASTERN BANCORPORATION,

Petitioner,

(FORMER OFFICERS AND DIRECTORS OF EASTERN BANCORPORATION),

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the decision in *Price v. Gurney*, 324 U.S. 100 (1945), precludes a Bankruptcy Court from exercising its equity powers in determining the validity of a Chapter 11 petition?

2. Whether the courts below erred in refusing to affirm the Bankruptcy Court's exercise of its equity powers, thereby wrongfully impairing the Bankruptcy Court's equity jurisdiction in violation of preeminent federal policy?

3. Whether the decision of the Third Circuit Court of Appeals affirming the reversal of the Bankruptcy Court's decision by the District Court so far departed from the accepted and usual course of bankruptcy proceedings as to call for exercise by the Supreme Court of its power of supervision under Rule 17.1(a) of the Rules of the United States Supreme Court?

LIST OF PARTIES

Eastern Bancorporation ("Eastern") is the debtor and petitioner herein. The respondents are former officers and directors of Eastern.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioner prays that a writ of certiorari be granted to review the order of the United States Court of Appeals for the Third Circuit entered in the above case on December 21, 1983 (as to which a rehearing *en banc* was denied on January 17, 1984).

OPINIONS BELOW

The order of the Court of Appeals and the District Court opinion are unpublished and are reprinted in the Appendix. The

Bankruptcy Court opinion has been reprinted in the Appendix and is reported at 23 B.R. 474 (E.D. Pa. 1982).

JURISDICTION

The order of the United States Court of Appeals for the Third Circuit was entered on December 21, 1983, affirming, without issuing an opinion, the opinion and order of the United States District Court for the Eastern District of Pennsylvania dated February 24, 1983, and entered February 25, 1983. The Court of Appeals denied a timely petition for rehearing on January 17, 1984.

The jurisdiction of this Court is invoked under Section 1254(1) of Title 28 of the United States Code, 28 U.S.C. §1254(1).

STATUTES INVOLVED

The statutory provisions involved are 11 U.S.C. §§105, 301 and 15 P.S. §§1306, 1308, 1319, 1501, 1502, 1505, 1509, 1613.1. The statutory provisions have been reprinted in the Appendix.

STATEMENT OF THE CASE

Eastern Bancorporation ("Eastern"), appellant and petitioner herein, is a corporation organized and existing under the laws of Pennsylvania and is a corporate affiliate of a group of related entities collectively known as The Capital First Group ("Capital First"). Other affiliates of Capital First include State Bancshares, Inc. ("Bancshares") and Aircraft Acceptance Corp. ("Aircraft"). Capital First's business interests expanded into many areas such as leasing and financing. One of the keystones of the Capital First financial structure was Eastern's controlling interest, as a regulated bank holding

company, in the stock of the State National Bank of Bethesda, Maryland (hereinafter "State National"), and the dividends ultimately channelled to Capital First by virtue of that control relationship. All of the affiliated corporations have common officers, directors and shareholders. The Capital First corporations have been continuously represented since the late 1960's by the law firm of Spector, Cohen, Gadon and Rosen ("Spector-Cohen"). Two of the firms' partners, Arthur Spector and Edward Cohen, have been officers, directors and shareholders in the Capital First corporations.

In December 1972, Capital First Corporation, a corporate member of the Capital First controlled group, acquired 750,000 shares of Eastern from Bancshares. Both companies were subsidiaries of Capital Corporate Resources (a successor to Capital Leasing Corporation). No approval of the Federal Reserve Board (hereinafter "FRB") was sought or obtained by Capital First Corporation. In June 1973, Capital First Corporation purchased an additional 750,000 shares of Eastern directly from Eastern. Subsequently, in 1973, at the direction of the FRB, and because Capital First Corporation was by then a *de facto* bank holding company, Capital First Corporation filed an application seeking authority to retain its control of these Eastern shares. (For purposes of clarity, a diagram of the Capital First affiliate corporate structure as of December 31, 1975, is set forth in the Appendix.)

The result of these various transactions was that by February 1976, Capital First directly owned two-thirds of all of the outstanding shares of Eastern and, by virtue of its majority ownership of Aircraft, which owned the other third, had complete control of Eastern and indirect control of State National. On February 11, 1976, the Board of Governors of the FRB denied Capital First Corporation's application for bank holding company status and directed that it divest itself of all interest in Eastern within thirty days. It was that FRB-ordered divestiture, and its

deadline of March 12, 1976, that prompted the transactions by which 1,500,000 shares of Eastern's stock were pledged to First Pennsylvania Bank N.A.

First Pennsylvania Bank N.A. ("First Pennsylvania ") is a national banking association with its principal place of business in Philadelphia, Pennsylvania. On March 12, 1976, First Pennsylvania entered into two separate but interrelated loan transactions with Capital First affiliates. First, it loaned Bancshares $900,000, the proceeds of which were used by Bancshares to acquire 750,000 shares of Eastern from Capital First; and second, it loaned $650,000 to Aircraft, the proceeds of which were used by Aircraft to repay certain obligations to Bancshares and to effect a release of an earlier pledge of 750,000 shares of Eastern common stock to Bancshares.

The documentation for both loans included virtually identical pledge agreements (the "Pledge Agreements") under which the Eastern stock was pledged to First Pennsylvania. At the time of the pledge, Eastern owned approximately 64 percent of the outstanding stock of State National, its only real asset. The Pledge Agreements were executed by Phillip Comerford in his capacity as an officer of both Bancshares and Aircraft. Mr. Comerford was also President of Eastern. The Bancshares Pledge Agreement was supplemented by an addendum pursuant to which Bancshares agreed, upon Aircraft's default, either to assume Aircraft's obligation or to buy the pledged stock for the amount of Aircraft's obligation.

First Pennsylvania also received separate but identical written opinions from Spector-Cohen on behalf of both Bancshares and Aircraft, in which Spector-Cohen stated its opinion that the Pledge Agreements were valid, legal, binding, and enforceable in the hands of First Pennsylvania. At no time did counsel object to the content, form, or legality of the Pledge Agreements or opine as to their

unenforceability under any applicable banking or bank holding company laws, whether state or federal. In fact, in a subsequent public Offering Circular of the State National Bank of Maryland, it was clearly disclosed that under the Pledge Agreement between First Pennsylvania and Bancshares, First Pennsylvania had the right, in the event of default, to vote shares of Eastern at a shareholders meeting.

By September 1976, Aircraft had defaulted on its loan. In February 1977, the parties restructured the loans so that Bancshares assumed Aircraft's obligations. After this assumption Bancshares owed First Pennsylvania approximately $1,495,000. Repayment of this amount was secured by a pledge of its 1,500,000 shares of Eastern stock. At the time the 1977 assumption transaction was consummated, the pledged stock certificates, along with irrevocable stock powers, were delivered to First Pennsylvania.

Eastern has never been a publicly traded corporation. When the loan was restructured, First Pennsylvania was not aware of any other outstanding shares of stock. After the assumption transaction, First Pennsylvania held 1,500,000 shares of the common stock of Eastern under the Pledge Agreements and 750,000 shares of the common stock of Eastern as co-trustee with Industrial Valley Bank under an indenture obligation. First Pennsylvania later learned that there were an additional 1,800 shares of stock held by other shareholders representing 0.08 percent of the shareholders. Thus, 99.92 percent of the stock was pledged to First Pennsylvania in either its corporate or fiduciary capacity.

Bancshares defaulted on the restructured loan in mid-1977. On several occasions, principals of Bancshares proposed the sale of Eastern's interests in State National as the only viable means to repay the debt. However, no definitive efforts were made to pay the debt nor were any programs or proposals suggested or adopted. In the early fall of 1980, First Pennsylvania learned that

a $1,000,000 Eastern indenture would mature on November 1, 1980, and that Eastern would be unable to pay the bondholder claims without liquidation of Eastern's State National holdings. The indenture was secured directly by Eastern's pledge of 186,679 shares of State National. A second secured Eastern indenture scheduled to mature on January 31, 2000, had also been in default since July 1979. The second indenture was secured by the pledge of Eastern's remaining 42,918 shares in State National. Suits by the indenture trustees to foreclose upon the State National stock pledged as security for the indentures would render First Pennsylvania's pledged stock of Eastern worthless.

Through public offerings of common stock, Eastern's interest in State National had been reduced to less than 40 percent, plainly insufficient to secure the indebtedness then due to First Pennsylvania of over $1,500,000 in principal plus interest. Eastern, by the Fall of 1980, owned approximately 230,000 shares of State National stock. In Mr. Comerford's opinion, the stock could be sold for $10 a share. If Mr. Comerford were correct, a sale of the State National stock at $10 a share would have left, after repayment of the first and second indentures, a deficiency owed to First Pennsylvania of over $700,000, and nothing would have remained for distribution to the other creditors and shareholders of Eastern. First Pennsylvania thus began to explore means by which all parties in interest would be treated fairly. Due to the imminent danger of the default under the first indenture, First Pennsylvania decided to exercise its rights under the Pledge Agreements, assume a management position, and initiate a voluntary bankruptcy proceeding to protect its interests and those of other shareholders and creditors in Eastern.

On October 24, 1980, First Pennsylvania delivered to Eastern's registered office in Philadelphia the two irrevocable stock powers executed by Bancshares, through Mr. Comerford, and a request to register the shares of stock in First Pennsylvania's name. Eastern

refused to register First Pennsylvania's name on its stock ledgers in spite of the irrevocable stock powers and the 1976 opinion letters of Spector-Cohen. On that date, Eastern's ultimate default on the first indenture was less than eight days away and there was a significant possiblity that all of its material assets, *i.e.*, the shares of State National, would be lost through foreclosure. First Pennsylvania simultaneously noticed and called a meeting of Eastern's shareholders to be held on October 31, 1980, and asked that Eastern notify all shareholders of the proposed meeting. Notices of the shareholders meeting were hand-delivered to Eastern's Philadelphia offices and sent to both the President and Secretary of Eastern at the offices of State National. A copy was also hand-delivered to Bancshares at the office of Spector-Cohen. At least seven days notice of the meeting was provided by First Pennsylvania through the efforts outlined above.

Since Eastern was part of Capital First, whose principals opposed the action requested by First Pennsylvania, and because First Pennsylvania anticipated a lack of cooperation by Eastern's management, First Pennsylvania did everything that could reasonably be expected under the circumstances to provide notice to the remaining shareholders who owned 0.08 percent of Eastern stock. First Pennsylvania gave notice of the October 31, 1980, shareholders meeting to the indenture trustees, and asked the indenture trustees to identify and notify any bondholders who also held Eastern common shares. Notice of the shareholders meeting was also published in *The Philadelphia Daily News* and *The Legal Intelligencer*, beginning October 25, 1980.[1] In that the holders of Eastern's additional 1,800 shares were apparently also bondholders under Eastern's first debenture issue, First Pennsylvania also asked Ronald Henderson, Vice President of

1. First Pennsylvania to date does not know the identity of the remaining Eastern shareholders because respondents have refused to produce records necessary to ascertain their identity.

Bank One Trust Company, Columbus, Ohio, an Indenture Trustee for that debenture issue, to assist in the notice process by giving notice of the shareholders meeting to any bondholders who also held shares of Eastern stock.

It is important to note that Eastern, then under the control of respondents, had been for many years a stagnant, non-operating entity. There had not been an annual meeting of Eastern's shareholders or Board of Directors for over five years. Eastern never even prepared financial statements. Eastern's only activities were the receipt of quarterly dividends from State National, the payment of interest to Eastern's indenture trustee, and the monitoring of certain litigation. Moreover, Eastern's corporate existence had been jeopardized by respondents' record of acknowledged violations of Eastern's own by-laws and Pennsylvania Business Corporation Law, including: (1) the failure to maintain an office in Pennsylvania in violation of 15 P.S. §1306; (2) the failure to hold meetings of its shareholders and directors in violation of 15 P.S. §1501; (3) the failure to maintain the original shareholder or transfer book or duplicate thereof in Pennsylvania in violation of 15 P.S. §1308; (4) the failure to give notice of board meetings to the President, and have its President and Secretary attend meetings in violation of its by-laws; and (5) the improper restricting of the transfer of shares in violation of 15 P.S. §1613.1(B).

Pursuant to First Pennsylvania's notices, a meeting of Eastern's shareholders was conducted as called on October 31, 1980. First Pennsylvania, as the holder of 99.92 percent of the shares, was the only shareholder that attended the meeting. No other shareholder, former officer, or director, attended despite receiving prior notification as set forth above. At the meeting, a new board of directors was elected, new officers were appointed,

and the by-laws of Eastern were amended.[2] A meeting of the newly elected Board of Directors was set for later that day. At the later meeting, the new Board of Directors authorized the new officers of Eastern to file a petition for reorganization of Eastern under Chapter 11 of the Bankruptcy Code. Shortly thereafter, Eastern's Chapter 11 petition was filed.

The former officers and directors of Eastern subsequently filed a motion to dismiss the Chapter 11 filing of the Bankruptcy Court. None of the holders of the remaining 0.08 percent of Eastern stock joined in the motion to dismiss. While many issues were raised in the motion, the issues germane to this petition were: (1) whether the meeting called by First Pennsylvania complied with the requirements of the Pennsylvania Business Corporate Law (herein "PBCL") and Eastern's by-laws; (2) whether First Pennsylvania's notice of the meeting of Eastern's shareholders was invalid for failing to set forth the "true" purpose of the meeting; and (3) whether the meeting of the Board was invalid due to purportedly improper notice. Thus, the thrust of the motion to dismiss was whether the voluntary petition under Chapter 11 of the Bankruptcy Code was duly authorized.

The Honorable Emil F. Goldhaber, Jr., Judge, United States Bankruptcy Court for the Eastern District of Pennsylvania, by opinion and order dated October 7, 1982 [reported at 23 B.R. 474 (E.D. Pa. 1982)] concluded that, based on the above facts, the Chapter 11 filing was fully authorized. Judge Goldhaber denied the motion to dismiss. The Bankruptcy Court held that the petition was validly authorized because: (1) the specific default provisions of the Pledge Agreements between the pledgee and the shareholder-pledgor of the debtor's stock took precedence over the general

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2. At the shareholders meeting on October 31, 1980, First Pennsylvania voted the shares which it held as pledgee in its corporate capacity and abstained from voting the shares which it held in its fiduciary capacity.

provisions of the PBCL; (2) under the default provisions of the Pledge Agreements, the Bank as pledgee succeeded to all of the corporate rights of the pledgor; (3) 99.92 percent of the debtor's shareholders received *actual* notice of the shareholders meeting at issue; (4) no violation of law occurred; and (5) strict compliance with the debtor's by-laws was unwarranted in light of the debtor's history of total disregard for corporate formality. The Bankruptcy Court noted that even assuming *arguendo* that technical violations of the PBCL or Eastern's by-laws might have occurred, the equities of the situation strongly favored First Pennsylvania, and that in light of their total disregard for the PBCL and Eastern's by-laws, the former officers and directors of Eastern would not be allowed to complain of First Pennsylvania's actions.

In seeking a public disclosure of the affairs of the company in the bankruptcy forum, First Pennsylvania, as virtually the sole shareholder, was concerned that the interests of all shareholders and creditors were fairly treated and protected by the court. The Bankruptcy Court, in making its decision, noted this Honorable Court's decision in *Price v. Gurney*, 324 U.S. 100 (1945), addressing the issue of who is the proper party to file a petition. The Bankruptcy Court determined that *Price* was distinguishable from the case at bar and not controlling because in this instance, unlike in *Price*, those who put the debtor in bankruptcy were authorized to do so. Further, the Bankruptcy Court found that 15 P.S. §1509, regarding the determination of shareholders of record, was not controlling in the instant situation since the specific provisions in the Pledge Agreement took precedence over the general provisions of the PBCL.

The former officers and directors of Eastern sought and were granted leave to appeal Judge Goldhaber's decision to the United States District Court for the Eastern District of Pennsylvania. Judge Donald W. VanArtsdalen, specifically noting that the

equities might very well favor First Pennsylvania, nonetheless held that the court could not consider the equities of the case in light of its determination that a technical violation of the PBCL law had occurred. Although Judge VanArtsdalen was concerned with the fact that the shares had not been transferred on the books of Eastern, his primary concern was that the shareholders did not receive at least ten days' notice of the shareholders meeting under 15 P.S. §1509, which statutory section the District Court found to be applicable. Judge VanArtsdalen found the notice sent was insufficient solely because it did not comply with the ten-day time period. In the District Court's view, the failure to provide an additional three days' notice was dispositive. The District Court concluded that equitable considerations could not be employed where it found a technical violation of what it determined to be an applicable statutory provision of Pennsylvania law. Accordingly, the District Court reversed the Bankruptcy Court's opinion and order.

The debtor appealed the reversal to the United States Court of Appeals for the Third Circuit. The Third Circuit, without issuing an opinion, affirmed the District Court. A rehearing *en banc* was denied by the Third Circuit.

This petition for certiorari to this Honorable Court followed thereafter.

REASONS FOR GRANTING THE WRIT

I.

Certiorari should be granted to address the important and unresolved question of whether this Court's decision in *Price v. Gurney*, 324 U.S. 100 (1945), precludes the exercise of the Bankruptcy Court's equity jurisdiction in determining the validity of a Chapter 11 filing.

As this Court has stated, "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity . . . [A] bankruptcy court is a court of equity at least in the sense that in the exercise of the jurisdiction conferred upon it by the Act, it applies the principles and rules of equity jurisprudence." *Pepper v. Litton*, 308 U.S. 295, 304 (1939) (citations omitted); *Taylor v. Standard Gas & Electric Co.*, 306 U.S. 307 (1939). There is an overriding consideration that equity governs the exercise of bankruptcy jurisdiction. *Bank of Marin v. England*, 385 U.S. 99 (1966). In discussing the intent of Congress in enacting Chapter X and Chapter XI of the Bankruptcy Act, this Court stated, in the case of *Securities and Exchange Commission v. United States Realty & Improvement Co.*, 310 U.S. 434, 457 (1940):

> While a bankruptcy court cannot, because of its own notions of equitable principles, refuse to award the relief which Congress has accorded the bankrupt, the real question is, what is the relief which Congress has accorded the bankrupt and is it more likely to be secured in a Chapter X or Chapter XI proceeding? In answering it we cannot assume that Congress has disregarded well settled principles of equity, the more so when Congress itself has provided that the relief to be given shall

> be "fair and equitable and feasible." Good sense and legal tradition alike enjoin that an enactment of Congress dealing with bankruptcy should be read in harmony with the existing system of equity jurisprudence of which it is a part.

The case of *Price v. Gurney*, 324 U.S. 100 (1945), did not require that a court ignore equitable considerations in determining the validity of a filing pursuant to the requirements of state law. In fact, the role that equity will play in a Bankruptcy Court's determination of a state law question was not addressed in *Price*, and has not been answered by this Court.

In *Price*, this Court held that the question of who could file a Chapter XI petition under the Bankruptcy Act was a question of state law. The case involved a shareholder who, as owner of seven shares of stock individually and as an agent for an additional 675 shares, filed a petition in the District Court in the name of the corporate entity, asking that the company be given relief under Chapter X of the Bankruptcy Act. The shareholder did not attempt to resort to or comply with applicable state law prior to filing the petition. Instead, the shareholder sought to utilize directly the Bankruptcy Court's power to adjust an intracorporate dispute. This Court held that as a matter of state law, it was the authorized officer of a corporation, and not the shareholder, which had the right to file a corporate bankruptcy petition. The issue of whether or not equitable considerations should be taken into account in determining the validity of a petition was neither raised nor addressed.

In the instant case, the Bankruptcy Court was faced with a different factual situation, which called out for the exercise of its equitable powers. It is not disputed that if the Board of Directors of Eastern was validly elected, then the Chapter 11 petition of Eastern was fully authorized. Although the Bankruptcy

Court was asked to address the issue of whether Eastern's Chapter 11 petition was fully authorized in accordance with state law, it could not and did not overlook the real substance of the transaction. The Bankruptcy Court concluded that, because of the contractual default provisions of the Pledge Agreements, First Pennsylvania succeeded to *all* of the rights of the pledgor of the Eastern stock and, therefore, had the authority to call the shareholders meeting and vote at that meeting. Moreover, based on respondents' total disregard for corporate formality and the fact that only First Pennsylvania could be injured by an alleged technical violation of state corporate law or Eastern's By-Laws, the court concluded that the respondents were estopped from raising claims of technical violations of state law or Eastern's By-Laws.[3] The Bankruptcy Court concluded that equitable considerations grounded in Pennsylvania case law, weighed against allowing respondents to raise claims based upon strict compliance with state law *citing McCay v. Luzerne & Carbon County Motor Transit Co.*, 125 Pa. Super. 217, 189 A. 772 (1937), and *Steinberg v. American Bantam Car Co.*, 76 F. Supp. 426 (W.D. Pa. 1948) (holding that in Pennsylvania the general equity powers of the courts are not limited by the PBCL). The Bankruptcy Court concluded that it could exercise its equitable powers to resolve a question of state law since it was not precluded from doing so by the decision in *Price* and the instant case was factually inapposite.

Even the District Court noted that "it may well be that the equities do favor First Pennsylvania." However, the District Court felt constrained to uphold form over substance, and held that the Bankruptcy Court acted improperly by allowing equitable considerations to enter into its decision. The District Court's

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3. It is important to note than none of the holders of the remaining 0.08 percent of Eastern's stock joined in the motion to dismiss the bankruptcy proceeding filed by respondents.

opinion and the affirmance by the Court of Appeals are a radical departure from the statutory grant of equitable power to the Bankruptcy Court under Section 105 of the Bankruptcy Code, 11 U.S.C. §105, and from this Court's decision in *Pepper v. Litton*, 308 U.S. 295, 304-05 (1939):

> *The bankruptcy courts have exercised these equitable powers* in passing on a wide range of problems arising out of the administration of bankrupt estates. They have been invoked *to the end that* fraud will not prevail, that *substance will not give way to form, that technical considerations will not prevent substantial justice from being done.* (Emphasis added.)

Accord, In re Smith Corset Shops, Inc., 696 F. 2d 971, 976 (1st Cir. 1982); *In re Garfinkle*, 672 F. 2d 1340, 1346-47 (11th Cir. 1982). *See* 1 Collier On Bankruptcy, §3.01[5][6][ii] (15th Ed. 1984) ("The new bankruptcy court will therefore be a court of equity. It will look through the form to the substance of any particular transaction [*citing Pepper v. Litton, supra*], and may contrive new remedies where remedies at law are inadequate.").

The equity jurisdiction of the Bankruptcy Court was reaffirmed in this Court's recent decision in *NLRB v. Bildisco*, 104 S. Ct. 1188 (1984), in which the court permitted the Bankruptcy Court to exercise its equity power and reject a collective bargaining agreement which was burdening the estate. The court stated: "The Bankruptcy Court is a court of equity . . . and must focus on the ultimate goal of Chapter 11 when considering these equities." *Id.* at 1197. The goal of Chapter 11, a successful reorganization of a financially distressed debtor, would be furthered by a decree from this Court which encourages the Bankruptcy Courts to broadly employ their equitable powers in order to do justice.

The District Court and the Court of Appeals totally ignored the role that equity may play in determining whether or not a petition is validly filed. *Price* did *not* address the role of equity in determining compliance with state law, nor has this Honorable Court subsequently had occasion to address this issue. The Bankruptcy Court concluded, based upon Pennsylvania law and the record of respondents' total disregard for corporate formality and compliance with state law, that respondents were precluded from raising technical claims against Eastern's Chapter 11 filing. The Bankruptcy Court was unwilling to prevent an insolvent corporation on the verge of liquidation from invoking the court's aid for the protection of all parties' interests.

The question of the role that the Bankruptcy Court's equity jurisdiction may play in resolving state law questions is an issue of great importance, especially in light of the preeminent federal policy in the field of bankruptcy and the clearly established rule that equity principles be given effect in the exercise of the Bankruptcy Court's jurisdiction. Since the Court of Appeals has addressed an issue which has never been resolved by any other federal court and this Court has provided no guidance on the issue, it is necessary that this Court provide such guidance because of the potential impact of this issue on the large number of bankruptcy cases filed which are of substantial importance to the business community. This departure from the recognized equity powers of the Bankruptcy Court's jurisdiction and the novel question raised in this case warrant this Court's review.

II.

Certiorari should be granted to address the extent to which the Bankruptcy Court generally may exercise its equitable jurisdiction in resolving questions of state law.

In accordance with the principles enunciated by this Court in *Price v. Gurney*, 324 U.S. 100 (1945), and other decisions regarding the broad equity jurisdiction of the Bankruptcy Court in the preeminent federal field of bankruptcy, Bankruptcy Courts have been employing, where appropriate, equitable considerations in resolving various questions of state law presented to the Bankruptcy Court. For example, if under state law a creditor asserting a lien by virtue of legal proceedings must file certain notices thereof which are required by state law, the Bankruptcy Courts have employed their equity jurisdiction and held that a trustee seeking to exercise its powers as a lien creditor under Section 544 of the Bankruptcy Code will be excused from such compliance with those state law requirements. *See Sampsell v. Straub*, 194 F. 2d 228 (9th Cir.), *cert. denied*, 343 U.S. 927 (1951); *see In re Hidalgo*, 96 F. Supp. 783 (W.D. La. 1951); *In re Johnson*, 28 B.R. 292 (N.D. Ill. 1983). As another example, equitable considerations have been relied upon by Bankruptcy Courts to convert terminated and therefore non-executory agreements under state law into assumable contracts for purposes of the Bankruptcy Code, even though the Bankruptcy Court decision alters property interests arising under state law. *See In re Huntington Ltd.*, 654 F. 2d 578 (9th Cir. 1981); *In re Fountainebleau Hotel Corp.*, 515 F. 2d 913 (5th Cir. 1975).

Numerous other cases have been reported wherein a Bankruptcy Court, in a variety of situations involving the resolution of a question of state law, has exercised its equitable powers to resolve the issue, even where the result is a technical

departure from state law. In *Matter of Amador*, 596 F. 2d 428 (10th Cir. 1979), the Tenth Circuit Court of Appeals affirmed the decision of the Bankruptcy Court that a secured creditor's debt was nondischargeable notwithstanding the creditor's failure to sell the collateral security as required by state law. The court stated that to apply the statutory requirement to enable appellant "to avoid the consequences of their wrongdoing . . . would be incompatible with not only the spirit of the statute but with the equity that must characterize bankruptcy proceedings." *Id.* at 431-32. The Bankruptcy Court, in the case of *In re Grocerland Cooperative, Inc.*, 32 B.R. 427 (N.D. Ill. 1983), exercised its equitable jurisdiction and allowed a holder of a beneficial interest in a land trust to assert a claim against the debtor, even though the holder was precluded from so recovering under Illinois state law. In *In re Garland Corp.*, 6 B.R. 452 (D. Mass. 1980), the Bankruptcy Court exercised its equitable powers to afford a creditor the opportunity of establishing a lien which could not be claimed under Florida state law. The Bankruptcy Court in *In re Adams Laboratories, Inc.*, 3 B.R. 503 (E.D. Va. 1980), held that its equity jurisdiction allowed it to apply the doctrine of estoppel to preclude a corporation which purchased another company from raising the statute of limitations under Georgia state law as a bar to a claim made by the shareholders of the purchased company. As another example, even though the Bankruptcy Code does not specifically authorize a Bankruptcy Court to consolidate substantially the assets and liabilities of different debtors, courts have been exercising the power to effect a substantive consolidation, based upon the court's general equitable powers under Section 105 of the Bankruptcy Code, 11 U.S.C. §105, even where a substantive consolidation violated or failed to comply with applicable state law in all respects. *See Matter of Lewellyn*, 26 B.R. 246 (S.D. Iowa 1982); *In re Vecco Const. Industries, Inc.*, 4 B.R. 407 (E.D. Va. 1980); *In re Continental Vending Machine Corp.*, 517 F. 2d 997 (2nd Cir. 1975), *cert. denied*, 424 U.S. 913 (1976); *Commerce Trust Co. v. Woodbury*,

77 F. 2d 478, 487 (8th Cir.), *cert. denied*, 296 U.S. 614 (1935); *Stone v. Eacho*, 127 F. 2d 284 (4th Cir.), *cert. denied*, 317 U.S. 635 (1942); *In re Commercial Envelope Mfg. Co., Inc.*, 14 C.B.C. 191 (S.D.N.Y. 1977).

The Bankruptcy Court in this case, when confronted with the issue of whether its equitable powers may be exercised in the resolution of the state law issue presented to it, found that its equity jurisdiction would be applicable. That decision was in accordance with the decisions of other Bankruptcy Courts. which had similarly applied equitable powers, even where the resulting decision constituted a departure from applicable state law. The District Court and Third Circuit Court of Appeals, however, incorrectly precluded the Bankruptcy Court from utilizing its equity jurisdiction. The impact of that ruling will be substantial on every case in the Third Circuit, and in other Circuits which follow the Third Circuit's ruling, where a Bankruptcy Court is asked to exercise its equitable jurisdiction in resolving a state law question. As can be seen from the sampling of cases cited above, the impact of the Third Circuit's ruling will be felt by debtors and shareholders, as well as by creditors. To resolve this important question of the relationship between the exercise of the Bankruptcy Court's equity jurisdiction and the resolution of state law questions, the United States Supreme Court should grant certiorari and exercise its supervisory power over the lower courts to provide guidance on this issue.

III.

The District Court decision and the Third Circuit Court of Appeals' affirmance so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of the Supreme Court s power of supervision under U.S. Sup. Court Rule 17.1(a).

It is an inescapable conclusion that both the District Court and the Third Circuit ignored the Bankruptcy Court's power to exercise its equitable powers in determining the validity of a Chapter 11 petition. *Bank of Marin v. England,* 385 U.S. 104 (1966). To resolve the question of interrelationship between the exercise of the Bankruptcy Court's equity jurisdiction and the requirement that state law govern the validity of a Chapter 11 petition, the United States Supreme Court should grant certiorari, and exercise its power of supervision over the lower courts to provide guidance on this issue.

CONCLUSION

We submit that the question involved here is one of sufficient importance requiring final determination by this Court. The federal courts, which have been granted a vital role by Congress in resolving the expectations of the business community in bankruptcy cases, should have guidance in this matter. Business corporations, creditors and stockholders similarly are entitled to an interpretation of the extent to which a Bankruptcy Court may exercise its equitable powers in resolving a state law question.

Respectfully submitted,

WILLIAM A. HARVEY
JOAN A. ZUBRAS
GARY P. LIGHTMAN

FELLHEIMER, EICHEN
& GOODMAN
Attorneys for Petitioner

JUDGMENT ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 83-1149

IN RE: EASTERN BANCORPORATION
Debtor in Possession

Eastern Bancorporation, debtor,
Appellant

(Bky No. 80-02962G)

DISTRICT JUDGE: Honorable Donald W. Van Artsdalen

Argued December 16, 1983

BEFORE: SEITZ, *Chief Judge*, GARTH and BECKER, *Circuit Judges*.

After consideration of the contentions raised by appellant, it is

ADJUDGED AND ORDERED that the judgment of the district court be and is hereby affirmed.

Judgment Order

Costs taxed against appellant.

By the Court,

s/ Seitz
Chief Judge

ATTEST:

s/ Sally Mrvos
Clerk

DATED: Dec. 21, 1983

DISTRICT COURT OPINION

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE: EASTERN BANCORPORATION

BANKRUPTCY ACTION

NO. 80-02962G

CIVIL ACTION

NO. 82-0306

Philadelphia, Pennsylvania

February 24, 1983

Before HONORABLE DONALD W. VanARTSDALEN, J.

APPEARANCES:

ALLAN D. WINDT, ESQ.,
PAUL ROSEN, ESQ.,
Attorneys for the Appellants

WILLIAM HARVEY, ESQ.,
Attorney for the Debtor

THE COURT: This case has come on appeal from a decison by Judge Goldhaber, a bankruptcy judge, of October 7, 1982, in which he ruled that the motion by former officers of the debtor, Eastern Bancorporation to dismiss the debtor's Chapter 11 petition be denied.

District Court Opinion

The question before the Court here is whether the decision of Judge Goldhaber is correct, and whether it should be upheld. If it should not be upheld, then the decision would be reversed, and the bankruptcy petition would be directed to be dismissed for lack of jurisdiction.

Factually, the facts are really not in dispute, at least what I consider to be the relevant facts are in no way in dispute, and there is no dispute as to the actual fact-finding by Judge Goldhaber.

It seems to me the real question is whether there was a correct application of the law to the facts by Judge Goldhaber.

Just very briefly reviewing what I consider to be the essential facts in this case, it would appear that a corporation by the name of — which I will call SBI — although that is not its full name, held approximately two-thirds of the stock of Eastern Bancorporation, and pledged those shares of stock to First Pennsylvania Bank and Trust Company sometime prior to 1980.

In 1977 it appears that SBI was in default on its loan, and that the First Pennsylvania Bank and Trust Company, as pledgee of the stock, had certain rights that it then could enforce.

The agreement between SBI and First Pennsylvania Bank and Trust Company was very broad in the powers and control that it gave to First Pennsylvania, as I will call it here, over the stock of the Eastern Bancorporation shares of stock which had been pledged by SBI.

Among other things provided was that upon default, they could immediately take control of the stock, and had the right

to vote the stock, and could also presumably foreclose on the stock and sell the stock to other parties.

It is clear that that agreement was between SBI and First Pennsylvania Bank, and was part of an overall rather complicated transaction between various corporate entities, which I think it's unnecessary to go into at this point. Eastern Bancorporation it has been contended was in some way closely related or affiliated with SBI, but I don't understand that there is any intention, and certainly there was no finding by Judge Goldhaber, nor is there any basis for determining that either SBI or Eastern Bancorporation were, for all practical purposes, one and the same, or the actions of one would be the actions of the other.

There's been no attempt to pierce the so-called "corporate veil," to say that the actions of one corporation were the actions of the other, and therefore, at least for purposes of this decision, it seems to me that we have to treat the actions of SBI and Eastern Bancorporation as separate and independent.

The agreement between SBI and First Pennsylvania was a valid agreement, binding between the parties to the agreement, nobody disputes that fact. And there has been a contention made that there was representation made by counsel, who apparently represented not only the SBI, but also Eastern Bancorporation, and who are counsel for the appellees in this proceeding, that because they had made representations to the effect it was a valid and binding agreement, that somehow that would have some effect upon Eastern Bancorporation.

I frankly don't understand that argument, and do not consider it to be a valid argument.

The problem is that although it was a valid binding agreement between SBI and First Pennsylvania, Eastern Bancorporation was not a party to that agreement, was not bound by the terms of the agreement as such, and therefore any suggestion in the agreement that upon default, First Pennsylvania automatically became, in effect, the shareholder in place of SBI, certainly could not be binding or obligatory upon Eastern Bancorporation.

On October 24, 1980, First Pennsylvania sent a notice to the secretary of Eastern Bancorporation demanding that the shares of stock be transferred to its name, and presented, so far as the record discloses, proper powers of authority for that transfer.

On the same date, and before any answer was received from the corporation, First Pennsylvania sent out notice to all of the shareholders of which it had knowledge and on which it had addresses, that a special meeting of the shareholders was being held on October 31, 1980, which would have been, I believe, six days later than the date that the notice went out, and it sent this notice out ostensibly as a shareholder, and called it a special meeting.

At this point it should be pointed out that there is evidence that Eastern Bancorporation had, for some years prior thereto, never held any annual meeting as required by its bylaws and had, in various ways, operated in a very informal manner, and probably in violation of the various corporate laws of Pennsylvania.

In any event, however, the notice that was sent out did not assert that it was being sent out by reason of the failure of the corporation to have held an annual meeting. As a shareholder it conceivably had the right to call a meeting at any time after the time for the annual shareholders' meeting, if there had not

been a shareholders' meeting, which is specifically provided for under state law, under 15 Purdon's Statute, §1501(b), in which it is provided that if an annual meeting shall not be called and held during such calendar year, any shareholder may call any meeting at any time thereafter.

It was called ostensibly pursuant to subsection (c) of 15 Purdon's Statute, §1501(b) as a special meeting.

That statute provides shareholders are entitled to cast at least one-fifth of the votes may call a special meeting, and upon written request of the corporation, the secretary shall fix a date for a meeting within 60 days, and if the secretary neglects or refuses to fix such a date, then the shareholders representing that portion of the shares of stock may themselves set the date and call the meeting.

In this case the demand was made upon the secretary to transfer the shares of stock. I'm not sure, and it is not important to my decision, as to whether there was also a demand that a shareholders' meeting be called by the secretary. So far as I know, there was no demand upon the secretary to fix a time for the meeting, but the secretary was sent a copy of the notice setting a meeting for initially October 29, 1980.

I thought that meeting was called for actually October 30th.

MR. ROSEN: I will show you Exhibit B from the record below, which is a copy of the notice and a copy of the request to the secretary of Eastern Bancorporation.

Do you have it in front of you, your Honor?

THE COURT: Yes.

MR. ROSEN: You will see that it does call for October 29, but the attachment is October 30th.

THE COURT: But apparently when the notice went out to the other shareholders it was October 31, 1980.

I don't think that that discrepancy is of any significance in this case.

There is a contention that the notice, which simply said that the purpose was to elect a new corporate Board of Directors, and to adopt proposed bylaws, was deficient because the true purpose for calling such a meeting would have been to have the new Board of Directors immediately file a voluntary petition for reorganization under Chapter 11 of the bankruptcy laws.

Again I don't think it's important to my decision in this case to pass on that particular issue, but it is my view that the notice would be sufficient, because all that took place at the purported meeting, all that the shareholders had the right to do at that meeting was to in fact elect a new Board of Directors, and to make certain proposed amendments to the bylaws.

The real crux of the question is whether First Pennsylvania in fact was a shareholder, and if not, whether it had the right to act as a shareholder, to the extent of sending out notice of the meeting. Whether, even if it was a shareholder, it had the right to send out the notice of the meeting without first notifying the secretary, and making a call of a meeting but having the secretary fix the date of the meeting, and of course then, finally, whether, aside from the calling and convening of the meetings,

whether in fact First Pennsylvania had the right to vote the shares at the meeting as a shareholder.

It is my view, and at least as I understand the decision of Judge Goldhaber, he likewise agreed that there were multiple violations of the Pennsylvania business corporation law, and said that he would uphold the Pennsylvania business corporation law; but then, in effect, concluded that these were simply technical violations, and that they could be in some way overlooked.

I know of no basis for overlooking them, and certainly no cases have been cited that convince me that these mandatory provisions of the state corporate business law, under the facts of this case, can be overlooked.

Now what were some of these problems and violations?

First of all, it is clear that First Pennsylvania was simply holding as a pledgee until at least the time that it demanded that there be a transfer of the stock on October 24, 1980.

15 Purdon's Statute, §1506, specifically provides that a shareholder whose shares are pledged, shall be entitled to vote thereon in person or by proxy, until the shares have been transferred on the books of the corporation to the pledgee, and thereafter the pledgee shall be entitled to vote the shares in person or by proxy.

The shares had not been transferred on the books of the corporation to First Pennsylvania, there is nothing in the record to show that, in fact, the demand that the shares be transferred was refused, except, I believe, through some letter from counsel on or about October 30, the day before the meeting.

District Court Opinion

I think that it is quite clear, under the law, where a demand is made to transfer shares of stock on a corporation, if the corporation responds that there are proceedings in state court that may be brought seeking injunctive relief, and there is certainly no reason to anticipate in view of the asserted urgencies and exigencies of this litigation, that they would not have been promptly handled had there been some application made.

I think also that it is clear under the law of Pennsylvania that the corporation not only does not have to recognize someone who is not a registered shareholder, but that in fact the corporation probably can't recognize one who is not a registered shareholder on the books.

There are other problems, however, that are involved, as to First Pennsylvania voting this stock, in any event, at the meeting.

15 Purdon's Statute, Section 1509 provides in part that unless a record date is fixed by the bylaws or Board of Directors, for the determination of shareholders entitled to receive notice of or vote at a shareholders' meeting, transferees of shares which are transferred on the books of the corporation, within 10 days next preceding the date of such meeting, shall not be entitled to notice of or to vote at such a meeting.

Now there has been called to my attention, and I know of no bylaws or any other corporation action which would change this part of the statute, and therefore it would appear clear that even if the shareholders' meeting had been properly called, even if the shares had been transferred on the date demanded of October 24th, that First Pennsylvania would even then not have had the right to vote the shares at that particular shareholders' meeting.

District Court Opinion

It has been also suggested that the notice was in other ways defective, that notice was not given to all of the shareholders of record, and again, it seems rather clear that one of the purposes of the requirement that were shareholders call a meeting, that they notify the secretary and the secretary sets a date, is to provide a reasonable method whereby notice will be given to all shareholders of record;

And I agree with arguments made by counsel, it is clear that if a shareholder wishes to call a meeting, and the secretary doesn't fix the time, the shareholder would certainly have a right to get the list of the registered shareholders, and their last known addresses, so that notice can be given.

Of course it is true that as a practical matter there is notice given to all but a very few shareholders.

The statute is pretty express as to how shareholders shall be notified, and the method for notification, and again I don't know that there's any basis to get around those provisions, other than through the express waiver of shareholders;

And there's no evidence of any waiver in this situation or in this case.

It's been suggested that what took place was some illegal action. I don't think there was any illegal action. It was simply a nullity, that is to say, someone who purported to be a shareholder, who may in fact as between the pledgor and pledgee, had a right to all of the entitlements of a shareholders, but so far as the corporation is concerned, until the shares were transferred on the books, should not be recognized as a shareholder by the corporation, sent out a notice of a special shareholders'

meeting, which was not sent out in accordance with statute, purported to vote at a meeting, which it would not have had the right to vote at that meeting, even if shares had been transferred when directed.

Now I know there has been argument made here, and made successfully before Judge Goldhaber, that the equities favor upholding the action that was taken by the First Pennsylvania Bank.

It may well be that the equities do favor the First Pennsylvania Bank.

It may well be, as argued by counsel for First Pennsylvania Bank, that they're the good guys, and the people on the other side are the bad guys, but unfortunately or fortunately, I think it's fortunately this is a court of law, also a court where equity does have its part to play, but where there are express statutory mandatory provisions, where certainly no cases have been called to my attention that would allow ignoring these several mandatory statutory provisions, I see no way that the action can be upheld.

This is not changing in any way any findings of fact that may have been made by Judge Goldhaber, but simply determining that the application of the law was erroneous under the facts as found by the Bankruptcy Court.

Therefore it seems to me I have no alternative but to reverse the action of the Bankruptcy Court, bankruptcy judge, to direct that the motion to dismiss the action be granted and I think that it's clear by everyone that if the Board of Directors was not properly elected, and it is my determination for the reasons set forth that the Board of Directors were not properly elected, that

any action that they took was not a proper corporate action, and that therefore they were not authorized, on behalf of the corporation, to file the voluntary petition in bankruptcy, and therefore the action of both decisions of the bankruptcy judge will be reversed, the action will be remanded, with directions to dismiss the petition.

However, because the parties may wish to seek appellate review of this, or to take some other appropriate action, I will stay the effect of this order for a period of ten days from this date.

MR. HARVEY: Thank you, your Honor.

MR. ROSEN: Thank you, your Honor.

BANKRUPTCY COURT OPINION

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In re Chapter 11

EASTERN BANCORPORATION

Debtor

Bankruptcy No. 80-2962G

OPINION

By EMIL F. GOLDHABER, Bankruptcy Judge:

The issue at bench is whether the debtor's petition for a reorganization under chapter 11 of the Bankruptcy Code ("the Code") was duly authorized under its corporate by-laws and the Pennsylvania Business Corporation Law ("the PBCL"). We conclude that the petition was validly authorized because: (1) the specific default provisions of the pledge agreement involved herein, made between the pledgee and the shareholder-pledgor of the debtor's stock, govern over the general provisions of the PBCL; (2) under those default provisions, the pledgee succeeded to all of the corporate rights of the pledgee; (3) 99.9% of the debtor's shareholders received *actual* notice of the special shareholders meeting at issue; and (4) strict compliance with the debtor's by-laws is unwarranted in light of the debtor's history of disregard for corporate formality.

The facts of the instant case are as follows:[1] Eastern Bancorporation ("the debtor") is a corporate member of related

1. This opinion constitutes the findings of fact and conclusions of law required by Rule 752 of the Rules of Bankruptcy Procedure.

entities collectively referred to as the Capital First Group.[2] On March 12, 1976, First Pennsylvania Bank N.A. ("First Pennsylvania") entered into two (2) separate, but interrelated loan transactions with Capital First affiliates. First, it loaned State Bancshares, Inc. ("SBI") $900,000.00, which amount was used by SBI to acquire 750,000 shares of the debtor from Capital First. Then, it loaned $650,000.00 to Aircraft Acceptance Corp. ("ACC"), the proceeds of which were used by ACC to pay an obligation to SBI and to effect a release of an earlier pledge of 750,000 shares of the debtor's common stock to SBI. By September, 1976, ACC had defaulted on its loan and, on February 2, 1977, the parties restructured the aforesaid loans whereby SBI assumed ACC's obligation.[3] As collateral for these loans, SBI delivered to First Pennsylvania two (2) blank irrevocable stock powers,[4] each representing 750,000 shares of the debtor's common stock, and the certificates representing the 1,500,000 shares of the debtor corporation.

SBI defaulted on the restructured loan in mid-1978. Consequently, First Pennsylvania delivered the two aforementioned irrevocable stock powers to the debtor's registered office in Philadelphia and requested that the 1,500,000 shares be

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2. *See* Exh. 1 to debtor's brief in opposition. Counsel for the debtor and counsel for the former officers and directors of the debtor have stipulated that the exhibits submitted by each party in connection with our consideration of the present motion to dismiss shall be deemed to have been admitted into evidence for purposes of the aforesaid motion only. *See* Stipulation filed on September 24, 1982.

3. *See* Exh. 8 to debtor's brief in opposition.

4. *See* Exh. 11 and Exh. 12 to debtor's brief in opposition.

registered in First Pennsylvania's name.[5] Simultaneous with the transfer request, First Pennsylvania noticed and called a special meeting of the debtor's shareholders on October 31, 1980.[6]

A special meeting of the debtor's shareholders was conducted as called on October 31, 1980. First Pennsylvania was the only shareholder represented at the meeting. At the meeting, amended by-laws were adopted, new corporate directors were elected and a meeting of the newly elected board of directors was set for later that same day. At this later meeting, the board of directors authorized the officers to file a petition for reorganization under chapter 11 of the Code. The chapter 11 petition so authorized at the October 31 meeting was filed on November 12, 1980. Subsequently, on November 26, 1980, a motion to dismiss that petition was filed by persons purporting to be the former officers, directors and stockholders ("the former officers") of the debtor. That motion alleges that the filing of the chapter 11 petition was, for various reasons, unauthorized and that, therefore, we do not have jurisdiction to entertain the petition.[7]

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5. *See* Exh. A to former officers' brief in support of motion to dismiss. However, pursuant to a restrictive legend appearing on the face of the stock certificates representing the 1,500,000 shares in question, no transfer could be made until the debtor corporation received an opinion from its counsel that the proposed transfer would not violate state and federal securities laws or the Bank Holding Act of 1956. For whatever reason, no such opinion was ever tendered to the debtor. In any event, by agreement of counsel reached at pre-trial conference on June 9, 1981, the issues at bench involve alleged violations of the Pennsylvania Business Corporation Law and the debtor's by-laws.

6. *See* Exh. B. to former officers' brief in support of motion to dismiss.

7. It is a fundamental principle of law that those who act to put a corporation into bankruptcy must have the authority to do so. *See* Price v. Gurney, 324 U.S. 100, 65 S. Ct. 513 (1945).

A. AUTHORITY TO CALL THE SPECIAL MEETING

The former officers repeatedly assert that only actual shareholders of the debtor - those whose names appear as such on the books of the corporation - are entitled to call a special meeting of the shareholders. In essence, the former officers contend that First Pennsylvania was not a record shareholder, and therefore not entitled to call the special meeting, because the pledged shares were never transferred to First Pennsylvania's name on the books of the debtor corporation. As a general proposition, we agree with the debtor.[8] However, in the instant case, the former officers apparently ignore the 1976 pledge agreement entered into between First Pennsylvania and SBI wherein shares of the debtor corporation were pledged to First Pennsylvania to secure debts owed to it by certain affiliates of the debtor. The 1976 pledge agreement provides as follows:

> 4. Any or all shares of the Pledge Stock held by the Bank hereunder may at *any time, at the option of the Bank*, be registered in the name of the Bank or its nominee, but until the occurrence of any Event of Default specified in the Loan Agreement the Pledgor shall remain the beneficial owner of the Pledged Stock and shall retain all the incidents of such ownership thereof. At any time after the occurrence of any Event of Default specified in the Loan Agreement, the *Bank may, without notice, exercise all voting and corporate rights at any meeting of the shareholders* of the

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8. *See, e.g.*, Lee v. Riefler & Sons, Inc. 43 F. 2d 364 (M.D. Pa. 1930); Fletcher, Cyclopedia of Corporations, vol. 12A, §5656 (1972).

issuers of the Pledged Stock and exercise any and all rights of conversion, exchange, subscription of any other rights, privileges, or options pertaining to any shares of the Pledged Stock as if it were the absolute owner thereof, including, without limitation, the right to exchange, at its discretion, any and all of the Pledged Stock upon the merger, consolidation, reorganization, recapitalization or other adjustment of the issuers of the Pledged Stock.

5. Upon the occurrence of any *Event of Default* specified in the Loan Agreement, the *Bank shall have the right to vote the shares of Pledged Stock* and to require that all cash dividends payable with respect to any part of the Pledged Stock be paid to the Bank, as additional collateral security hereunder, until applied to the Obligations. (emphasis added).[9]

The Addendum to the 1976 pledge agreement also provides that:

1. Upon the occurrence of an event of default under the Loan Agreement of even date herewith between AAC and the Bank, SBI agrees to purchase immediately from the Bank and the Bank agrees to sell to SBI all of the Pledged Stock, as that term is defined in the Pledged Agreement, and any amendments or suppliers thereto.

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9. *See* Exh. 2 to debtor's brief in opposition.

> 2. The entire purchase price shall be paid either in cash or certified check, delivered at the closing, or through assumption by SBI of payments due by AAC to Bank under a Loan Agreement with Bank dated March 12, 1976.[10]

More importantly, First Pennsylvania received separate but identical written opinions on behalf of SBI and Aircraft from the former officers' present counsel regarding the 1976 loan transactions. The opinion letters provided in pertinent part:

> 6. The Agreement and the other loan documents have been duly executed and delivered by the Company and constitute *LEGAL, VALID* and *BINDING* obligations of the Company, enforceable subject to usual equitable principles, against the company in accordance with their respective terms, except as enforceability may be limited by bankruptcy, insolvency, reorganization or similar laws affecting creditors rights generally. . .
>
> 9. No authorization, consent, approval, license exemption of, our filing, registration with any court or governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign is or will be necessary to the valid execution, delivery and performance by the company of the agreement and the other loan documents . . .

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10. *See* Exh. 5 to debtor's brief in opposition.

> 12. Upon delivery to [First Pennsylvania] of certificates representing 750,000 shares of the common stock of Eastern Bancorporation [the "Securities"] properly endorsed or accompanied by proper powers relating thereto, there will have been created in [First Pennsylvania's] favor a valid and perfected pledge of the securities. (emphasis added).[11]

To accept the former officers' argument that First Pennsylvania could not call a special meeting because it was not a registered shareholder of the debtor would mandate that we disregard totally the 1976 and 1977 pledge agreements[12] - agreements (1) made between First Pennsylvania and affiliates of the debtor; (2) to secure debts owing to First Pennsylvania by affiliates of the debtor; (3) collaterallized with shares of the debtor corporation; and (4) approved by the former officers' present counsel. We decline to do so and, consequently, we conclude that First Pennsylvania had the requisite authority to call the special shareholders meeting notwithstanding the fact that

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11. *See* Exh. 6 and Exh. 7 to debtor's brief in opposition.

12. Counsel for the debtor repeatedly asserts that the filing of the petition was unauthorized because First Pennsylvania was never a shareholder of record of the debtor. This argument addresses only one portion of what appears to be a bifurcated pledge agreement wherein First Pennsylvania contracted for two (2) different and distinct rights. First, the 1976 pledge agreement gives First Pennsylvania the right to register the pledged shares in its own name. More importantly, the agreement gives First Pensylvania the right upon default - regardless of whether the pledged shares are registered in its own name - to exercise all voting and corporate rights of the pledgor. Counsel for the former officers has failed to explain why we should not give credence to this alternative right contracted for the 1976 pledge agreement.

First Pennsylvania was not a registered stockholder as of the date of that special meeting.

Since under Pennsylvania law, a shareholder "entitled to cast at least one-fifth of the votes which all shareholders are entitled to cast at the particular meeting" can call a special meeting of the shareholders;[13] and since SBI was, in fact, a shareholder of the debtor "entitled to cast at least one-fifth of the votes . . .";[14] and since SBI assigned, pursuant to the aforementioned 1976 pledge agreement, all its corporate rights in the debtor corporation to First Pennsylvania, it inescapably follows, we think, that First Pennsylvania, as pledgee of all of SBI's corporate rights in the debtor, also had the authority to call a special meeting of the debtor's shareholders.

B. ALLEGED VIOLATIONS OF THE PBCL AND THE DEBTOR'S BY-LAWS.

Philip Comerford, the debtor's purported president since 1977 and the president of SBI at the time of the 1976 and 1977 pledge

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13.

> C. Special meetings of the shareholders may be called at any time by the president, or the board of directors, or shareholders entitled to cast at least one-fifth of the votes which all shareholders are entitled to cast at the particular meeting, or by such other officers or persons as may be provided in the articles or by-laws.

Pa. Stat. Ann. tit. 15, §1501(c) (Purdon 1967).

14. Initially, SBI and ACC each owned 50% of the debtor's outstanding stock totalling 1,500,000 shares. Later 750,000 additional shares were issued to Capital First. Thereafter, certain of the holders, of the debtor's debentures exercised warrants thereunder and purchased 1,800 shares of the debtor's common

(Cont'd)

agreements, testified that: (1) the debtor had not held a shareholders meeting since 1975 (N.T. Comerford 5/8/81 at 66, 67); (2) he had no specific recollection of there having been a board of directors meeting of the debtor since 1975 (N.T. Comerford 5/8/81 at 66, 67); (3) the debtor had not prepared financial statements or records of operations since 1976 (N.T. Comerford 5/8/81 at 23); (4) the debtor had not filed tax returns of any kind since 1977 (N.T. Comerford 5/8/81 at 20); and (5) the debtor's only current activities are the ownership of stock in State National Bank ("SNB") and the monitoring of litigation on some leases that are being collected by various attorneys (N.T. Comerford 5/8/81 at 16). Against this history of disregard for corporate formality,[15] the former officers ask that we "uphold the Pennsylvania Business Corporation Law and Eastern's (the debtor's) by-laws." We will, of course, uphold the PBCL, but we cannot, in light of the present record, give force and effect to the debtor's "by-laws."

The Pennsylvania Superior Court has stated that "the rules with reference to special meetings, the validity of the business transacted, and the necessity of notice like many other rules respecting mode of corporate action may be overcome by proof of contrary custom or usage on the part of the directors." *McCay v. Luzerne & Carbon County Motor Transit Co.*, 125 Pa. Super., 217, 222, 189 A. 772, 774 (1937). In addition, the court, in *Steinberg v. American Bantam Car Co.*, 76 F. Supp. 426 (W.D. Pa. 1948), stated that:

(Cont'd)

stock. SBI eventually became owners of 2,250,000 shares of the debtor's stock. *See* debtor's brief in opposition, p. 9 n.4. This explanation of the debtor's shareholder distribution was uncontroverted by the former officers.

15. The debtor lists additional uncontroverted violations of the PBCL and its own by-laws. *See* debtor's brief in opposition, pp. 10, 11.

> [T]he Court [ ] should [not] permit, on the part of those in control of a corporation, through the reliance of technicalities or strict compliance with the provisions of law, to place [sic] a shareholder in a position where he is denied the right, due to limitations on time, to communicate or draw to the attention of all the stockholders of the corporation facts and circumstances which relate to the detailed condition of the company . . .*[t]his is especially true where the affairs of the corporation have been conducted in such a manner that [substantial losses have been] sustained . . .over a prolonged period of time.* (emphasis added). 76 F. Supp. at 436[16]

Nevertheless, the former officers assert that First Pennsylvania could not have voted at the October 31 shareholders meeting because, even assuming that First Pennsylvania became a shareholder of the debtor on October 24, it was not a shareholder of record at least ten (10) days before the October 31 meeting. As a general proposition, the former officers are correct.[17]

16. *See* debtor's brief in opposition, p. 12.

17.

> . . . Unless a record of date is fixed by the by-laws or the board of directors for the determination of shareholders entitled to receive notice of, or vote at, a shareholders' meeting, transferees of shares which are transferred on the books of the corporation within ten days next preceding the date of such meeting shall not be entitled to notice of or to vote at such meeting.

Pa. Stat. Ann. tit. 15, §1509 (Purdon 1967)

However, the former officers, once again, ignore the plain words of the default provisions of the pledge agreement. To reiterate, that agreement provides that First Pennsylvania, *upon the occurrence of any event of default*, "may without notice, exercise all voting and corporate rights at meeting of the shareholders."[18] Therefore, we conclude that the 1976 pledge agreement governs over the general provisions of section 1509 of the PBCL and, therefore, we find that that section has no applicability under the present facts.[19]

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18. *See* note 9 and accompanying text *supra*.

19. The former officers imply that because §427 of the PBCL was repealed, the agreement between First Pennsylvania and SBI, which permits First Pennsylvania to vote SBI's stock in the debtor, is invalid. §427 provided as follows:

> As between the pledgor and the pledgee of capital stock pledged to secure a specific loan with a fixed period or periods of maturity, the right to vote shall be determined as follows: First, By the written agreement of the pledgor and pledgee. Second. In all other instances the pledgor shall be held to be the owner and entitled to the right to vote.

Pa. Stat. Ann. tit, §427 (repealed in 1933).

Section 427 was replaced by §1506, which provides that:

> Shares standing in the name of a trustee or other fiduciary and shares held by an assignee for the benefit of creditors, or by a receiver, may be voted either in person or by proxy of the trustee, fiduciary, assignee or receiver. A shareholder whose shares are pledged shall be entitled to vote thereon, in person or by proxy,until the shares have been transferred on the books of the corporation to the pledgee or nominee, and thereafter the pledgee or nominee shall be entitled to vote the shares in person or by proxy.

(Cont'd)

Bankruptcy Court Opinion

Additionally, the former officers assert that even if First Pennsylvania was entitled to call the special meeting of the shareholders, the meeting was, in any event, invalid because the debtor's secretary had sixty (60) days to set the date of the special meeting.[20] We conclude, however, that the present record warrants an abatement of the sixty day requirement imposed by section 1501(c) of the PBCL. As mentioned earlier, the debtor had not held a shareholders meeting since 1975 and the debtor's president could not recall whether there had been a meeting of the board of directors since 1975. Furthermore, its management and corporate operations were at a virtual standstill.[21] Finally, the

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(Cont'd)

Pa. Stat. Ann. tit. 15, §1506 (Purdon 1967).

However, §1506 does not say that voting rights cannot be determined by written agreement between pledgor and pledgee. The section simply does not address that question.

20.

* * *

> At any time, upon written request of any person or persons who have duly called a special meeting, it shall be the duty of the secretary to fix the date of the meeting, to be held not more than sixty days after the receipt of the request and to give due notice thereof. If the secretary shall neglect or refuse to fix the date of the meeting and give notice thereof the person or persons calling the meeting may do so.

Pa. Stat. Ann. tit. 15, §1501(c) (Purdon 1967). *See also* art. III, §303 of the debtor's by-laws at Exh. E to former officers' brief in support of motion to dismiss.

21. *See* note 16 *supra*. *See also* notes of testimony of Philip Comerford, 5/8/81 at 16.

debtor had defaulted on separate indenture obligations in addition to its affiliates' default under the First Pennsylvania pledge agreements.[22] Apparently, the default provisions of the indenture obligations gave the indenture trustee the immediate right to sell the debtor's only assets.[23] Under these circumstances, we conclude that the sixty-day requirement was unnecessary.

Finally, the former officers allege that the new directors were not validly elected because the purpose of the special shareholders meeting was not disclosed. In its notice, First Pennsylvania specifically indicated that amended by-laws would be adopted and that a new board of directors would be elected.[24] The former officers contend, however, that because First Pennsylvania formulated a plan as early as October 9, 1980 to put the debtor into bankruptcy,[25] the real purpose of the special meeting was intentionally concealed.

Our initial difficulty with this contention is that we cannot reconcile how the shareholders were never advised of the true

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22. *See* debtor's brief in opposition, p. 12.

23. At the time of the attempted transfer of the pledge shares by First Pennsylvania, the debtor's ultimate default on the indentures (secured by the pledge of 186,679 shares of SNB) was eight (8) days away. *See* debtor's brief in opposition, p. 31, 32. This allegation is uncontradicted by the former officers. The debtor's only material asset is its ownership of 30.67% of the shares of common stock of SNB. *See* former officers' brief in support of motion to dismiss, p. 12 n. 4, wherein they state that the debtor's entire shareholdings in SNB are pledged to secure this public indenture obligation.

24. *See* Exh. C. and Exh. D to former officers' brief in support of motion to dismiss.

25. *See* former officers' reply brief, p. 21.

purpose of the meeting if: (1) First Pennsylvania, representing 66.6%[26] of the debtor's shareholders pursuant to the terms of the pledge agreement, was the "perpetrator" of this alleged concealment; (2) SBI, representing 33.3% of the debtor's shareholders, was an inactive corporation;[27] and (3) the remaining shareholders, .0007%, were unknown to First Pennsylvania, as evidenced by its letter of October 24,1980 to the Bank One Trust Company.[28]

In any event, we find it indeed significant that a special meeting called by a party representing a clear majority of the

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26. As of October 24, 1980, the debtor had 2,251,800 shares of common stock outstanding. Two million two hundred fifty thousand (2,250,000) (99.9%) of those shares were owned by SBI and pledged to First Pennsylvania. The remaining 1,800 shares were held by unidentified debtor bondholders. Only 1,500,000 of the pledged shares are involved in the instant case. Another 750,000 shares are pledged to First Pennsylvania's and Industrial Valley Bank's Trust Departments as co-trustees under defaulted indenture obligations of Capital First Corporation, an affiliate of the debtor. *See* debtor's brief in opposition, p. 14. The former officers do not challenge these figures. Consequently, First Pennsylvania is a 66% "stockholder" (1,500,000 ÷ 2,251,800).

27. 750,000 ÷ 2,251,800. However, although all of SBI's stock in the debtor is pledged to First Pennsylvania, SBI, as pledgor, retains voting rights over the 750,000 shares pledged to First Pennsylvania and Industrial Valley Bank as co-trustees of defaulted Capital First debentures. The transaction by which First Pennsylvania and Industrial Valley Bank came to hold the 750,000 shares is, according to the debtor, unrelated to the issue at bench. The co-trustees have not exercised any voting or other rights in the pledged stock. *See* debtor's brief in opposition, p. 14 n. 7 and p. 57 n. 12. In addition, SBI, according to the former officers, is an inactive corporation. *See* former officers' brief in support of motion to dismiss, p. 12 n. 4.

28. 1,800 ÷ 2,251,800. *See* Letter to Ronald Hendersen, Exh. 18 to debtor's brief in opposition.

debtor's shareholders in order to elect a new board of directors would be deemed by the former officers to be not important enough to have at least one representative present at that meeting.

Given the former officers' continuing disregard of the PBCL and the debtor's by-law, we find it ironic indeed that the former officers, in their present motion to dismiss, assert that "[i]t should go without saying that a shareholder cannot pick and choose which corporate requirements it will comply with and which requirements it will not comply with when noticing and voting at a meeting. . . ."[29]

C. ALLEGED INADEQUACIES IN NOTICING THE SPECIAL MEETING.

In response to the former officers' argument that the new directors were not validly elected because the minority shareholders were not given notice of the special shareholders meeting, we begin by pointing out that 99.9% of the debtor's shareholders were given *actual* notice of the special meeting.[30] Documents were hand-delivered to the debtor at its registered office in Philadelphia on October 24, 1980. Included in that package of documents were:

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29. *See* former officers' reply brief, p. 19.

30.

> Written notice of every meeting of the shareholders shall be given by, or at the direction of, the person authorized to call the meeting, to each shareholder of record entitled to vote at the meeting, at least five days prior to the day named for the meeting, unless a greater period of notice is required elsewhere in this act in a particular case. . . .

Pa. Stat. Ann. tit. 15, §1502 (Purdon 1967).

(1) a letter to the secretary of the debtor regarding the transfer of the 1,500,000 shares; (2) a letter to the secretary of the debtor regarding notice of the special meeting; and (3) a call of the special meeting addressed to the debtor's president.[31] In addition, First Pennsylvania, on the same day, asked the indenture trustee to identify and give notice of the special meeting to some 1,800 bondholders who apparently constituted the minority shareholders of the debtor corporation.[32] Furthermore, notices of the special meeting were published in two (2) Philadelphia newspapers of general circulation.[33] Finally, notices were delivered by air freight to the debtor's secretary in Rockville, Maryland.[34]

In any event, the former officers' contentions concerning inadequate notice must be viewed in light of the fact that the overwhelming majority of the debtor's shareholders (99.9%)[35] received *actual* notice of the time, place and purpose of the special shareholders meeting and their shares were represented.

We are mindful of the United States Supreme Court's command that, if parties "are to be allowed to put their corporation into bankruptcy, they must present credentials to the

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31. *See* Affidavit of Service, Exh. 13 to debtor's brief in opposition.

32. *See* Letter to Ronald Henderson, Exh. 18 to debtor's brief in opposition.

33. *See* Proofs of Publication, Exh. 16 and Exh. 17 to debtor's brief in opposition.

34. *See* Federal Express receipt, Exh. 14 to debtor's brief in opposition.

35. *See* Affidavit of Service on the debtor and Affidavit of Service on SBI, Exh. 13 and Exh. 15, respectively, to debtor's brief in opposition.

bankruptcy court showing their authority.'"[36] The debtor contends, alluding to the Supreme Court's instruction that "it is not enough that those who seek to speak for the corporation may have the right to obtain that authority,'"[37] that because First Pennsylvania proceeded to call the special meeting as "*record holder* of 1,500,000 shares of Eastern Bancorporation common stock" and voted at the special meeting as "*record holder* of 1,500,000 shares of the corporation," First Pennsylvania did not have the authority to act as it did.

As previously demonstrated, we find that First Pennsylvania had the authority to call the special meeting and vote the pledged shares *even if* it was never a shareholder of Eastern. To deny First Pennsylvania the rights it validly contracted for with the debtor's shareholder simply because it acted as "record owner" rather than as "pledgee of all the pledgor's corporate rights" would, it seems to us, be putting form over substance and equity. In *Price*, *supra* note 36, the Supreme Court was not presented with a situation where those who put their corporation into bankruptcy had the authority to do so. Rather, in that case a *shareholder* filed a petition in the name of the corporation. That shareholder, obviously, did not have the authority to so file. In the instant case, however, we conclude that First Pennsylvania had the right to call the special meeting and elect new board members. In the instant case, those validly elected board members authorized the filing the chapter 11 petition. Consequently, we conclude that *Price* is not controlling under the facts of the present case. The fact simply remains that those who put the debtor into bankruptcy in this case were, in fact, validly authorized to do so.

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36. *See* Price v. Gurney, 324 U.S. 100, 107, 65 S. Ct. 513, 516 (1945).

37. *Id.* at 106, 65 S. Ct. at 516.

Based on all the above, we will dismiss the former officers' motion to dismiss.

BANKRUPTCY COURT ORDER

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In re Chapter 11

EASTERN BANCORPORATION

Debtor Bankruptcy No. 80-02962G

ORDER

AND NOW, to wit, this 7th day of October, 1982, it is

ORDERED that the motion of the former officers of the debtor to dismiss the debtor's chapter 11 petition be, and the same hereby is, DENIED.

s/ Emil F. Goldhaber
EMIL F. GOLDHABER
Bankruptcy Judge

RELEVANT STATUTORY PROVISIONS

Section 105 of Title 11 of the United States Code, 11 U.S.C. §105, provides:

§105. Power of court

(a) The bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.

(b) Notwithstanding subsection (a) of this section, a bankruptcy court may not appoint a receiver in a case under this title.

Section 301 of Title 11, United States Code, 11 U.S.C. §301, provides:

§301. Voluntary cases

A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter. The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter.

Section 1306 of Title 15, Purdon's Pennsylvania Statutes, 15 P.S. §1306 provides:

§1306. Registered office

Every business corporation shall have and continuously maintain in this commonwealth a registered office which may, but need not, be the same as its place of business. The address, including street and number, if any, of the initial registered office,

shall be stated in the articles of the corporation, as heretofore provided in this act.

Section 1308 of Title 15, Purdon's Pennsylvania Statutes, 15 P.S. §1308 provides:

§1308. Corporate records; inspection

A. Every business corporation shall keep at its registered office or principal place of business an original or duplicate record of the proceedings of the shareholders and of the directors, and the original or a copy of its by-laws, including all amendments or alterations thereto to date, certified by the secretary of the corporation, and shall keep at its registered office or principal place of business or at the office of its transfer agent or registrar an original or a duplicate share register, giving the names of the shareholders, their respective addresses and the number and classes of shares held by each. Every such corporation shall also keep appropriate, complete and accurate books or records of account, which may be kept at its registered office, or at its principal place of business.

B. Every shareholder shall, upon written demand under oath stating the purpose thereof, have a right to examine in person or by agent or attorney, during the usual hours for business for any proper purpose, the share register, books or records of account, and records of the proceedings of the shareholders and directors, and make copies or extracts therefrom. A proper purpose shall mean a purpose reasonably related to such person's interest as a shareholder. In every instance where an attorney or other agent shall be the person who seeks the right to inspection, the demand under oath shall be accompanied by a power of attorney or such other writing which authorizes the attorney or other agent

to so act on behalf of the shareholder. The demand under oath shall be directed to the corporation at its registered office in this Commonwealth or at its principal place of business.

Section 1319 of Title 15, Purdon's Pennsylvania Statutes, 15 P.S. §1319, provides:

§1319. Insolvency or bankruptcy

Whenever a business corporation shall be insolvent or in financial difficulty, the board of directors may, by resolution and without the consent of the shareholders, authorize and designate the officers of the corporation to execute a deed of assignment for the benefit of creditors, or file a voluntary petition in bankruptcy, or file an answer consenting to the appointment of a receiver upon a bill in equity filed by creditors or shareholders, or, if insolvent, file an answer to an involuntary petition in bankruptcy admitting the insolvency of the corporation and its willingness to be adjudged a bankrupt on that ground.

Section 1501 of Title 15, Purdon's Pennsylvania Statutes, 15 P.S. §1501, provides:

§1501. Meetings of shareholders

A. Meetings of shareholders may be held at such place within or without this Commonwealth as may be provided in the by-laws or as may be fixed by the board of directors pursuant to authority granted by the by-laws. Unless the by-laws provide otherwise, all meetings of the shareholders shall be held in this Commonwealth at the registered office of the corporation.

Relevant Statutory Provisions

B. The by-laws may provide for the number and the time of meetings of shareholders, but at least one meeting of the shareholders shall be held in each calendar year for the election of directors, at such time as shall be provided in the by-laws, or as may be fixed by the board of directors pursuant to authority granted by the by-laws. Failure to hold the annual meeting at the designated time shall not work any forfeiture or dissolution of the corporation. If the annual meeting shall not be called and held during such calendar year, any shareholder may call such meeting at any time thereafter.

C. Special meetings of the shareholders may be called at any time by the president, or the board of directors, or shareholders entitled to cast at least one-fifth of the votes which all shareholders are entitled to cast at the particular meeting, or by such other officers or persons as may be provided in the articles or by-laws. At any time, upon written request of any person or persons who have duly called a special meeting, it shall be the duty of the secretary to fix the date of the meeting, to be held not more than sixty days after the receipt of the request and to give notice thereof. If the secretary shall neglect or refuse to fix the date of the meeting and give notice thereof the person or persons calling the meeting may do so.

D. Adjournment or adjournments of any annual or special meeting may be taken but any meeting at which directors are to be elected shall be adjourned only from day to day, or for such longer periods not exceeding fifteen days each, as may be directed by shareholders who are present in person or by proxy and who are entitled to cast at least a majority of the votes which all such shareholders would be entitled to cast at an election of directors, until such directors have been elected.

Relevant Statutory Provisions

Section 1502 of Title 15, Purdon's Pennsylvania Statutes, 15 P.S. §1502, provides:

§1502. Notice of Meetings of Shareholders

"Written notice of every meeting of the shareholders shall be given by, or at the direction of, the person authorized to call the meeting, to each shareholder of record entitled to vote at the meeting, at least five days prior to the day named for the meeting, unless a greater period of notice is required elsewhere in this act in a particular case. When a meeting is adjourned, it shall not be necessary to give any notice of the adjourned meeting or of the business to be transacted at an adjournment meeting, other than by announcement at the meeting at which such adjournment is taken, unless otherwise provided in the by-laws."

Section 1505 of Title 15, Purdon's Pennsylvania Statutes, 15 P.S. §1505, provides:

§1505. Elections of directors; cummulative voting

A. Unless otherwise provided in the by-laws, elections for directors need not be by ballot, except upon demand made by a shareholder at the election and before the voting begins. Except as otherwise provided in subsection B of this section or in the articles of a business corporation which is not a close corporation, in each election of directors of a business corporation every shareholder entitled to vote shall have the right to multiply the number of votes to which he may be entitled by the total number of directors to be elected in the same election by the holders of the class or classes of shares of which his shares are a part, and he may cast the whole number of such votes for one candidate

or he may distribute them among any two or more candidates. The candidates receiving the highest number of votes from each class or group of classes entitled to elect directors separately up to the number of directors to be elected in the same election by such class or group of classes shall be elected. If the articles or a by-law adopted by the directors pursuant to section 210 of this act[1] or by the shareholders provides a fair and reasonable procedure of the nomination of candidates, only candidates who have been nominated in accordance therewith shall be eligible for election.

B. The shareholders of a business corporation not incorporated hereunder, the shareholders of which were not entitled to cumulate their votes for the election of directors at the date the corporation became or becomes subject to the provisions of this act, shall be entitled so to cumulate their votes only if and to the extent its articles so provide.

Section 1509 of Title 15, Purdon's Pennsylvania Statutes, 15 P.S. §1509, provides:

§1509. Determination of shareholders of record.

Unless the by-laws otherwise provide, the board of directors may fix a time, not more than fifty days prior to the date of any meeting of shareholders, or the date fixed for the payment of any dividend or distribution, or the date for the allotment of rights, or the date when any change or conversion or exchange of shares will be made or go into effect, as a record date for the determination of the shareholders entitled to notice of, or to vote at, any such meeting, or entitled to receive payment of any such dividend or distribution, or to receive any such allotment of rights, or to exercise the rights in respect to any such change,

conversion, or exchange of shares. In such case, only such shareholders as shall be shareholders of record on the date so fixed shall be entitled to notice of, or to vote at, such meeting or to receive payment of such dividend,or to receive such allotment of rights, or to exercise such rights, as the case may be, notwithstanding any transfer of any shares on the books of the corporation after any record date fixed, as aforesaid. The board of directors may close the books of the corporation against transfers of shares during the whole or any part of such period, and in such case written or printed notice thereof shall be mailed at least ten days before the closing thereof to each shareholder of record at the address appearing on the records of the corporation or supplied by him to the corporation for the purpose of notice. While the stock transfer books of the corporation are closed, no transfer of shares shall be made thereon. Unless a record date is fixed by the by-laws or the board of directors for the determination of shareholders entitled to receive notice of, or vote at, a shareholders' meeting, transferees of shares which are transferred on the books of the corporation within ten days next preceding the date of such meeting shall not be entitled to notice of or to vote at such meeting.

Section 1613.1 of Title 1501, Purdon's Pennsylvania Statutes, 15 P.S. §1613.1, provides:

§1613.1. Restrictions on transfer of securities

A. A written restriction on the transfer or registration of transfer of a share or other security of a business corporation, if permitted by this section and noted conspicuously on the security, may be enforced against the holder of the restricted security or any successor transferee of the holder including an executor, administrator, trustee, guardian or other fiduciary

entrusted with like responsibility for the person or estate of the holder. Unless noted conspicuously on the security, a restriction, even though permitted by this section, is ineffective except against a person with actual knowledge of the restriction.

B. A restriction on the transfer or registration of transfer of securities of a business corporation may be imposed either by the articles or by the by-laws or by an agreement among any number of security holders or among such holders and the corporation. No restriction so imposed shall be binding with respect to securities issued prior to the adoption of the restriction unless the holders of the securities are parties to an agreement or voted in favor of the restriction.

C. A restriction on the transfer of securities of a business corporation is permitted by this section if it:

(1) Obligates the holder of the restricted securities to offer to the corporation or to any other holders of securities of the corporation or to any other person or to any combination of the foregoing, a prior opportunity, to be exercised within a reasonable time, to acquire the restricted securities; or

(2) Obligates the corporation or any holder of securities of the corporation or any other person or any combination of the foregoing, to purchase the securities which are the subject of an agreement respecting the purchase and sale of the restricted securities; or

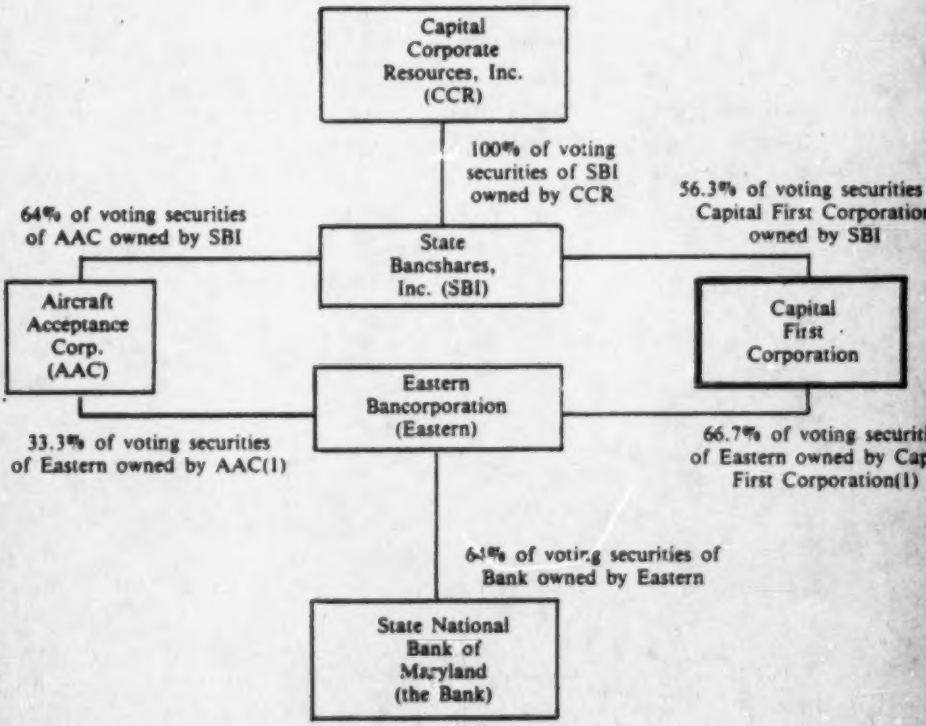
(3) Requires the corporation or the holders of any class of securities of the corporation to consent to any proposed transfer of the restricted securities or to approve the proposed transferee of the restricted securities; or

(4) Prohibits the transfer of the restricted securities to designated persons or classes of persons, and such designation is not manifestly unreasonable.

D. Any restriction on the transfer of the shares of a business corporation for the purpose of maintaining its status as an electing small business corporation under Subchapter S of the Internal Revenue Code of 1954,[1] shall be conclusively presumed to be for a reasonable purpose.

E. Any other lawful restriction on transfer or registration of transfer of securities is permitted by this section.

CAPITAL FIRST AFFILIATE CORPORATE STRUCTURE AS OF DECEMBER 31, 1975



EXCERPTS FROM STATE NATIONAL BANK OF MARYLAND OFFERING CIRCULAR

211,927 SHARES

STATE NATIONAL BANK OF MARYLAND

Common Stock

(PAR VALUE $2.50 PER SHARE)

SUBSCRIPTION PRICE $6.00 PER SHARE

State National Bank of Maryland (the "Bank") is offering to holders of its Common Stock the right, evidenced by nontransferable warrants, to subscribe to 211,927 shares of common stock at $6.00 per share in the ratio of one new share for each three shares held of record at the close of business on January 31, 1978. However, each shareholder will have the right to purchase at least 100 shares in the offering, regardless of the number of shares held. No fractional shares will be issued and, accordingly, if fractional shares result from application of the foregoing ratio, such shares will be rounded up to the next full share. Shareholders who exercise all rights issued to them will have the right to subscribe to shares not subscribed to by other shareholders (an "oversubscription privilege") on a pro rata basis in proportion to the number of shares oversubscribed, if available, at $6.00 per share. Of the 566,341 shares of the Bank outstanding on January 31, 1978, Eastern Bancorporation ("Eastern") owned 229,597 shares, representing about 40%. Eastern does not presently intend to exercise rights received by it.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE COMPTROLLER OF THE CURRENCY NOR HAS THE COMPTROLLER PASSED UPON THE ACCURACY OR ADEQUACY OF THIS OFFERING CIRCULAR.

Offering Circular

NO AGENT OR OFFICER OF THE BANK OR ANY OTHER PERSON HAS BEEN AUTHORIZED TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATIONS OTHER THAN THOSE CONTAINED IN THE OFFERING CIRCULAR AND, IF GIVEN OR MADE, SUCH INFORMATION AND REPRESENTATIONS SHOULD NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE BANK.

	Subscription Price	Underwriting Commissions	Proceeds To Bank (1) (2)
Per Share.....	$ 6.00	None	$ 6.00
Total (211,927).....	$1,271,562	None	$1,271,562

(1) The shares offered hereby are being offered initially by the Bank through a rights offering to shareholders of record on January 31, 1978 at $6.00 per share. Shares not subscribed to by the shareholders to whom the rights thereto are initially allocated will be subject to the oversubscription privilege of shareholders who exercise all rights given to them at a price of $6.00 per share, and thereafter may be offered at this price by the Bank to employees and other persons selected by or known to the Bank or officers and directors of the Bank as potential investors. If shares remain unsubscribed to after the offer to Bank employees and others, the Bank may negotiate with broker-dealers to reoffer any remaining shares to the public at a price which will return to the Bank at least $6.00 per share. There is no assurance that any of the shares offered hereby will be sold. The Bank will retain all funds received on account of subscriptions regardless of the number of shares sold. See "Plan of Distribution" herein.

(2) Before deducting expenses to be incurred by the Bank in connection with this offering estimated at $30,000.

Offering Circular

THE SUBSCRIPTION OFFER WILL EXPIRE AT 5:00 P.M., E.D.S.T. ON MAY 15, 1978.

The date of this Offering Circular is April 14, 1978
MAIN OFFICE—11616 Rockville Pike, Rockville, Maryland 20852
TELEPHONE NUMBER—(301) 881-7000

* * *

PRINCIPAL SHAREHOLDERS

The Bank had 461 shareholders of record as of December 31, 1977. The following table sets forth the record and beneficial ownership at such time, and also of each person known to the Bank to own more than 10% of such securities, and by the directors and officers of the Bank as a group.

Name and Address	Ownership	Amount Owned	Percentage of Class
Eastern Bancorporation 1700 Market Street Philadelphia, PA	Record and Beneficial	229,957	40.54
Officers and Directors as a group (19 persons)	Record and Beneficial	91,059(1)	16.08

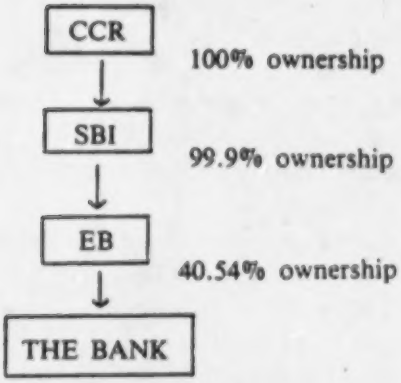
(1) Does not include shares in which Messrs. Cohen, Spector and Comerford may have an indirect interest through ownership of shares in Capital Corporate Resources, Inc. ("CCR"), the ultimate parent of Eastern Bancorporation ("EB"). Such indirect interest is derived by allocating shares of the Bank held by EB to the percentage interest held by such persons in CCR, and amounts to approximately 66,688 shares or an additional 11.78%.

Assuming (i) successful completion of this offering and (ii) that, as anticipated, officer and director shareholders purchase the shares being offered to them hereby. Bank officers and directors will directly own, as a group,

121,412 shares or 15.60% of shares outstanding of the Bank and indirectly own, through stockholdings in CCR (as referred to in Note (1) above), 66,688 shares or approximately 8% of shares outstanding. The foregoing amounts do not include shares which may be purchased by officers and directors pursuant to oversubscription since it cannot now be determined how many of such shares will be available or the amount of oversubscriptions, if any, by other shareholders. However, EB has indicated to the Bank that it will not exercise rights granted to it to subscribe for shares offered hereby.

EB is a registered bank holding company under the Bank Holding Company Act of 1956, as amended, and is registered as such with the Board of Governors of the Federal Reserve System. EB has no active business interests; the principal asset of EB is stock of the Bank and EB also has other lease and loan receivables. As of September 30, 1977, EB had a net worth of about $1,830,000 and an operating loss for the nine months of about $373,000. After allowance for (1) the excess of EB's investment in the Bank over the present market value of the Bank's shares and (2) certain doubtful receivables from State Bancshares, Inc. ("SBI"), EB has a negative tangible net worth.

Of the 2,251,800 shares of EB currently outstanding, 2,250,000 are owned by SBI. All the outstanding capital stock of SBI is owned by CCR, a bank holding company registered with the Federal Reserve System. CCR has no active business and its sole material asset is shares of SBI. The following diagram summarizes the corporate ownership:



1,500,000 of the shares of EB owned by SBI representing approximately ⅗ of total shares of EB outstanding are pledged to the First Pennsylvania Bank N.A. to secure certain loans by such bank to SBI. Principal and interest payments are delinquent on such loans, but First Pennsylvania Bank has not to date sought to foreclose on the EB stock as a result of such non-payment. Under the Pledge Agreement between First Pennsylvania Bank and SBI. First Pennsylvania Bank has the right in the event of default to vote shares of EB at meetings of EB's shareholders. Another 750,000 shares of EB owned by SBI (representing approximately the remaining ⅕ of EB) was acquired by SBI in consideration of a $900,000 note secured by the 750,000 shares. Such note is without recourse to SBI. The Note has been pledged by its holder, Capital First Corporation, a former affiliate of SBI, to First Pennsylvania Bank as Trustee for non-affiliated creditors of Capital First Corporation. Payments on this Note are also delinquent, but First Pennsylvania Bank has not sought to foreclose on this remaining stock.

The 229,957 shares of the Bank owned by EB are pledged to two unaffiliated banks located in Ohio and in the District of Columbia as trustee for holders of approximately $3,100,000 in outstanding notes of EB. EB presently is current on all principal and interest payments due to such

noteholders. In the event of a future default by EB it may be anticipated that the trustee banks will proceed to foreclose on such shares and to dispose of them in compliance with the Uniform Commercial Code and applicable banking laws and regulations. Such foreclosure could result in the acquisition of the 229,957 shares by a third party or parties. Such shares alone or together with other shares could constitute effective control of the Bank.

In addition to the foregoing, the Bank has entered into an agreement with Capital Auto Lease, a company affiliated with the parents of the Bank, whereby the Bank has agreed to provide certain services with respect to automobile leases as to which Capital Auto Lease is lessor. Under the terms of such agreement, the Bank collects lease payments from lessees and makes payments to creditors of Capital Auto Lease who financed the purchase of the automobiles under lease. For such services the Bank is receiving a total fee of $600 per month. Approximately 40 leases are involved.

The following table sets forth the record and beneficial ownership of the voting securities of CCR by each person who, as of December 31, 1977 owned of record or, to the Bank's knowledge owned beneficially more than 10% of such securities, and by directors and officers of the Bank as a group.

Name	Relationship to the Bank	Type of Ownership	Shares Owned Common	Preferred	Percentage of Class Common	Preferred
Arthur R. Spector	Chairman of the Board and Director	Record and Beneficial	88,874	-0-	9.9	-0-
Edward E. Cohen	Chairman of the Executive Committee and Director	Record and Beneficial	126,791	47.5	14.5	7.1%
Robert M. Cohen(1)	None	Record and Beneficial	112,920	-0-	12.9	-0-
Officers and Directors of the Bank as a group (3 persons)		Record and Beneficial	253,116	47.5	29.0	7.1

(1) Robert M. Cohen is the brother of Edward E. Cohen.

No. 83-1686

In The

Supreme Court of the United States

October Term, 1983

In Re:

EASTERN BANCORPORATION,

Petitioner,

(FORMER OFFICERS AND DIRECTORS OF EASTERN BANCORPORATION),

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Were the people who authorized the filing of a bankruptcy petition on behalf of Eastern Bancorporation (Eastern), officers and directors of Eastern, as they purported to be; that is, were they validly elected under Pennsylvania law?

LIST OF PARTIES

Eastern Bancorporation is the respondent herein. It was put into bankruptcy by the petitioners, who purported to be acting as officers and directors of Eastern. The District Court and the Third Circuit Court of Appeals held that the petitoners had never been elected officers and directors of Eastern under the governing Pennsylvania corporate law statutes.

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF IN OPPOSITION

STATUTES INVOLVED

The only statutes involved are the Pennsylvania corporate law statutes relating to the election of officers and directors; 15 P. S. §§1501(c), 1502, 1506 and 1509.

STATEMENT OF THE CASE

The material facts are undisputed. On March 12, 1976, First Pennsylvania Bank N.A. ("First Pennsylvania") entered into a

loan transaction with State Bancshares, Inc. ("SBI") (App. 3:606).[1] On February 2, 1977, the loan was restructured, at which time SBI delivered to First Pennsylvania two blank stock powers in Eastern Bancorporation ("Eastern"), each representing 750,000 shares of Eastern's common stock (App. 2:400-402, 2:435-463, 3:606).

SBI subsequently defaulted on the restructured loan (App. 3:607). First Pennsylvania, therefore, devised a plan whereby it would cause Eastern to file a petition for reorganization under Chapter 11 of the Code (App. 2:312, 2:575).

By letter dated October 25, 1980, First Pennsylvania requested Eastern's secretary to transfer the 1,500,000 shares owned by SBI into First Pennsylvania's name (App. 1:214, 3:606-607). This was not done. SBI's stock in Eastern, like all of Eastern's stock, bore a restriction stating that the shares could not be transferred unless Eastern's counsel rendered an opinion that the proposed transfer would not result in a violation "of applicable state and federal securities laws or the Bank Holding Act of 1956." (App. 2:327). Eastern's counsel was unwilling so to opine both because the requested transfer appeared to be in violation of the terms of the Financial Institution Article of the Code of Maryland and because it appeared to be in violation of the Federal Bank Holding Company Act (App. 1:257-258).

Nevertheless, although First Pennsylvania never became the record owner of SBI's stock in Eastern, the bank, by letter dated October 24, 1980, notified the secretary of Eastern to forward to the stockholders of Eastern a notice that First Pennsylvania as the "record owner of 1,500,000 shares of Eastern

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1. All references to the Appendix (filed with the Third Circuit) are cited as "App. x:y," the "x" denoting the volume of the Appendix, and the "y" denoting the page(s) of that Appendix.

Bancorporation common stock" had called a special meeting of Eastern's shareholders (App. 1:255). Eastern's secretary did not, of course, forward First Pennsylvania's notice to Eastern's stockholders. In addition to the fact that First Pennsylvania was not a record shareholder in Eastern, it would not have had a right to call a special shareholders meeting even if it had been a shareholder. 15 P. S. §1501(c) expressly provides that a shareholder may not fix the date of a special shareholders meeting unless the secretary of the corporation fails to set a date within 60 days.

Nevertheless, ignoring the fact that it was not a shareholder in Eastern, that it had no right to call a special shareholders meeting, and that the minority shareholders had not been notified of the meeting, First Pennsylvania proceeded to hold a special shareholders meeting on October 31, 1980 (App. 1:259-270). At that meeting — attended only by representatives of First Pennsylvania — the bank "elected" a new board of directors. The new board then met and authorized the filing of a petition for reorganization under Chapter 11 of the Bankruptcy Code (App. 1:271-289).

The Chapter 11 petition so authorized was filed on November 12, 1980. On November 26, 1980, Eastern filed a motion to dismiss that petition. The Bankruptcy Court denied that motion on October 7, 1982. The District Court reversed the Bankruptcy Court on February 24, 1983, holding that the Bankruptcy Court had no jurisdiction over the subject Chapter 11 bankruptcy petition because it was filed without authorization. Following a December 16, 1983 argument before the Third Circuit Court of Appeals, the Third Circuit affirmed the District Court's order on December 21, 1983.

SUMMARY OF ARGUMENT

The only issues raised in the instant litigation concern the interpretation and application of Pennsylvania corporate law.

The petitioner, the District Court and the Third Circuit have all recognized (i) that the Bankruptcy Court was without jurisdiction to consider the Chapter 11 petition if the filing of the petition was not authorized by Eastern, and (ii) that in order to prove that Eastern authorized the filing of the petition, the petitioner had to establish that the people who gave that authorization were validly elected directors and officers under Pennsylvania law. The only issue on which the petitioners differed with the District Court and the Third Circuit was as to whether the people who authorized the filing of the bankruptcy petition were, in fact, validly elected under Pennsylvania law. The District Court held that they had not been validly elected for a plethora of reasons, and the Third Circuit summarily affirmed.

The petitioner's argument relating to the equitable powers of the bankruptcy courts are, therefore, totally besides the point. The subject Chapter 11 petition was dismissed for jurisdictional reasons.

REASONS FOR DENYING THE WRIT

Neither the petitioner nor any of the courts below disputed the three fundamental principles upon which Eastern's motion to dismiss was based; in light of those principles, however, the Bankruptcy Court was necessarily obligated to grant the motion to dismiss, and the District Court and Third Circuit so recognized.

First, neither the petitioner nor any court disputed that the Bankruptcy Court was without jurisdiction to consider the Chapter 11 petition if the filing of the petition was not authorized by Eastern. As summarized by the Supreme Court in *Price v. Gurney*, 324 U.S. 100, 65 S. Ct. 513, 517 (1945), if parties "are to be allowed to put their corporation into bankruptcy, they must present credentials to the bankruptcy court showing their authority." The debtor in *Price* could not make such a showing; the Court,

therefore, affirmed the dismissal of the bankruptcy petition on the ground that "[t]he jurisdiction which Congress has given the bankruptcy court over the debtor and its property . . . does not extend to this situation." 65 S. Ct. at 516.

The second fundamental principle that the petitioner and the courts below did not dispute was that in order to prove that Eastern authorized the filing of the petition, the petitioner had to establish that the people who gave that authorization were validly elected directors under local law. *See, e.g., In re Mississippi Valley Utilities Corp.*, 2 F. Supp. 995, 997 (D. Del. 1933) (adjudication of bankruptcy vacated because the "directors" who authorized the filing of a bankruptcy petition had been elected at a shareholder meeting that had not been properly noticed); *In re Campbell County Hardware Co.*, 15 F. 2d 78, 81 (E.D. Tenn. 1924) (adjudication of bankruptcy vacated because, *inter alia*, it did "not appear that the special [shareholders] meeting was called in pursuance of article 1, section 3, of the by-laws"); *see also, In re Joseph Feld & Co.*, 38 F. Supp. 506, 507 (D.N.J. 1941) ("[t]he Court . . . should not assume jurisdiction of a 'voluntary proceeding,' which, as in this case, is based on an invalid resolution which had its origin in an illegal meeting of directors").

Finally, the third fundamental principle that the petitioner and the courts below did not dispute was that if, in fact, the people who authorized the filing of the petition were not validly elected, the petition had to be dismissed regardless of whether (had First Pennsylvania acted differently) they *could* have been validly elected. That was the precise holding in *Price v. Gurney*.

> If the District Court finds that those who purport to act on behalf of the corporation have not been granted authority by local law to institute the proceedings, it has no alternative but to dismiss the petition. ***It is not enough that those who seek***

> *to speak for the corporation may have the right to obtain that authority.* . . . [N]owhere is there any indication that Congress bestowed on the bankruptcy court jurisdiction to determine that those who in fact do not have the authority to speak for the corporation as a matter of local law are entitled to be empowered to file a petition on behalf of the corporation. (65 S. Ct. at 516-17). (Emphasis added.)

In its opinion, the District Court recognized that, as applied to the undisputed facts in this case, those principles necessitated dismissal of the subject bankruptcy petition for at least three independent reasons.

I.

THE "NEW" DIRECTORS WERE NOT VALIDLY ELECTED BECAUSE FIRST PENNSYLVANIA WAS NOT A SHAREHOLDER OF EASTERN.

The petitioner has never disputed that it must prove that the "directors" who put Eastern into bankruptcy were validly elected. It also has never disputed that those "directors" were purportedly elected by First Pennsylvania, which as purported "record holder of $1,500,000 shares of Eastern," voted such shares in favor of the subject "directors." Finally, the petitioner also has never disputed that First Pennsylvania did not have the right or authority to vote *as it did*[2] — it was never the owner or record holder of any Eastern stock.

---

2. First Pennsylvania is not and has never been a shareholder of Eastern because it is undisputed that none of Eastern's stock has ever been registered in the name of First Pennsylvania. *See, e.g., Lee v. Riefler & Sons, Inc.*, 43 F.2d 364, 365 (M.D. Pa. 1930) ("The stockholder of a corporation means one

(Cont'd)

The petitioner argues merely that the Court should ignore what actually took place, and rule in favor of the petitioner based upon what could have taken place. Specifically, the petitioner argues that although First Pennsylvania called the October 31 special shareholders meeting as a supposed shareholder of Eastern and although it purportedly voted its own stock at that meeting, it *could* have accomplished the same end by, instead, voting SBI's stock in Eastern.[3] There are two problems with the petitioner's analysis; it is irrelevant, and it is erroneous.

A. The petitioner's contention that First Pennsylvania could have voted SBI's stock is irrelevant.

As discussed above, the petitioner's argument as to what First Pennsylvania supposedly could have done is irrelevant because, as recognized by the Supreme Court in *Price v. Gurney*, the only thing that matters is what First Pennsylvania did, not what the petitioner says First Pennsylvania could have done.

(Cont'd)

whose status as such appears on the books of the corporation. . . . A person who holds shares of stock in pledge, although the shares are assigned in blank by the registered owner, does not become a stockholder until the shares are transferred to him on the books of the corporation"). The Bankruptcy Court so acknowledged on page 4 of its opinion (App. 3:603).

3. The difference insofar as First Pennsylvania is concerned has enormous ramifications. As discussed on pages 3-4 of Eastern's December 3, 1982, Reply Brief in Support of its Motion to Dismiss Chapter 11 Petition for Violation of the Federal Bank Holding Company Act (App. 3:719-720), First Pennsylvania would have been acting in contravention of the Federal Bank Holding Company Act if it had acted as the petitioner suggested it could have acted. As a result, First Pennsylvania (contrary to the position taken herein by the petitioner), has advised the Federal Reserve Board that it did not acquire control of Eastern until October 1980, when SBI's stock in Eastern was supposedly transferred into the bank's name. *Id.* First Pennsylvania has never taken the position (advocated by the petitioner) that it had "the automatic right" to vote the pledged (Eastern) stock in the event of a default. Appellant's Brief to the Third Circuit at 19.

B. The petitioner's contention that First Pennsylvania could have voted SBI's stock in Eastern is erroneous.

It was expressly acknowledged in Eastern's brief before the District Court and in Judge VanArtsdalen's opinion that the pledged agreement was enforceable "as between the parties thereto" (SBI and First Pennsylvania).[4] The only question vis-a-vis the agreement relates to the effect of the agreement on Eastern — which was not a party thereto. The issue was summarized by Judge VanArtsdalen as follows:

> The agreement between SBI and First Pennsylvania was a valid agreement, binding between the parties to the agreement, nobody disputes that fact. . . .
>
> The problem is that although it was a binding agreement between SBI and First Pennsylvania, Eastern Bancorporation was not a party to that agreement, was not bound by the terms of the agreement as such and therefore any suggestions in the agreement that upon default, First Pennsylvania automatically became, in effect, the shareholder in place of SBI, certainly could not be binding or obligatory upon Eastern Bancorporation.[5]

The governing Pennsylvania statute, 15 P.S. §1506, provides as follows:

> . . . A shareholder whose shares are pledged shall be entitled to vote thereon, in person or by

---

4. App. 1:014, 3:754.

5. App. 1:014-015.

> proxy, until the shares have been transferred on the books of the corporation to the pledgee or nominee, and thereafter the pledgee or nominee shall be entitled to vote the shares in person or by proxy.

The statute is clear and straightforward; the petitioner has never even contended that it is somehow ambiguous. Necessarily, therefore, the analysis of the effect of the pledge agreement on Eastern must not only begin with the statute, but must end with the statute. It expressly provides that a corporation (Eastern) whose shares are the subject of the pledge shall allow the pledgee (SBI) to vote such shares "until the shares have been transferred on the books of the corporation."[6] There is, as the District Court recognized,[7] simply nothing more that can or need be said.

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6. *See* 8A Pennsylvania Law Encyclopedia, *Corporations* §135 at 240. ("In the case of pledged shares of stock, the pledgor is entitled to vote the shares, in person or by proxy, until the shares have been transferred to the pledgee or nominee on the books of the corporation, and thereafter the pledgee or nominee is entitled to vote the shares in person or by proxy"). This is, in fact, hornbook law. *See, e.g.*, 1 *Collier on Bankruptcy* §4.05 at 594 n.27 ("One who asserts equitable ownership to all stock in a corporation is not entitled to exercise the rights and privileges of a stockholder and thus has no authority to institute voluntary proceedings").

7. App. 1:020 ("[I]t is clear that First Pennsylvania was simply holding as a pledgee until at least the time that it demanded that there be a transfer of the stock on October 24, 1980. 15 P.S. §1506, specifically provides that a shareholder whose shares are pledged, shall be entitled to vote thereon in person or by proxy until the shares have been transferred on the books of the corporation to the pledgee, and thereafter the pledgee shall be entitled to vote the shares in person or by proxy. The shares had not been transferred on the books of the Corporation to First Pennsylvania. . .").

II.

THE "NEW" DIRECTORS WERE NOT VALIDLY ELECTED BECAUSE FIRST PENNSYLVANIA HAD NO RIGHT TO SET THE DATE OF THE SPECIAL SHAREHOLDERS MEETING.

15 P.S. §1501(c) details certain requirements that must be met before a shareholder can call a special shareholders meeting. First Pennsylvania did not comply with that statute. Necessarily, therefore, in addition to the fact that this action was properly dismissed because the bank was never a shareholder in Eastern (*see* Point I, *supra*), this action was properly dismissed because the subject "directors" were not elected at a lawfully held shareholders meeting.

First Pennsylvania's failure to comply with Section 1501(c) is manifest and undisputed. The statute provides that a shareholder desiring a special shareholders meeting must make a "written request" to the company that such a meeting be scheduled. The secretary of the corporation then has "60 days after receipt of the request" in which to schedule the meeting. The shareholder is vested with the authority to schedule the meeting on its own only "[i]f the secretary shall neglect or refuse to fix the date of the meeting and give notice thereof."

There are, therefore, two prerequisites to a shareholder scheduling its own meeting: (i) a "written request" by it to the company requesting that the company schedule the meeting, and (ii) a failure by the company to schedule the meeting. Neither prerequisite was satisfied with regard to the October 31, 1980, shareholders meeting scheduled by First Pennsylvania. The bank did not, prior to scheduling the meeting, make any request whatsoever to Eastern that such a meeting be held, let alone allow Eastern the opportunity to consider and act on the request. It

is undisputed that the first Eastern learned of the October 31 meeting was on October 24, when First Pennsylvania had already scheduled a special shareholders meeting:

> First Pennsylvania Bank, N.A. the record holder of 1,500,000 shares of Eastern Bancorporation common stock has called a special meeting of shareholders for 10:00 a.m., October 29, 1980 [sic] at 1900 Land Title Building, Broad and Chestnut Streets, Philadelphia, Pennsylvania. . . .[8]

Summarizing, the subject special shareholders meeting was manifestly called in violation of 15 P.S. §1501(c).

III.

THE "NEW" DIRECTORS WERE NOT VALIDLY ELECTED BECAUSE FIRST PENNSYLVANIA HAD NO RIGHT TO VOTE AT THE SPECIAL SHAREHOLDERS MEETING.

15 P.S. §1509 provides that new shareholders are not entitled to vote at shareholders meetings until 10 days after the date on which they become shareholders. Even if one were to accept First Pennsylvania's position, therefore, that it became a shareholder of Eastern on October 24, it necessarily would not have been entitled to vote, as it did, at the October 31 special shareholders meeting.[9]

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8. App. 1:215.

9. Judge VanArtsdalen so held on pages 11-12 of his opinion (App. 1:021-022).

IV.

THE "NEW" DIRECTORS WERE NOT VALIDLY ELECTED BECAUSE EASTERN'S MINORITY SHAREHOLDERS WERE NOT GIVEN THE REQUISITE NOTICE OF THE SPECIAL SHAREHOLDERS MEETING.

The petitioner has never disputed that 15 P.S. §1502 requires that "written notice" of any meeting of shareholders "must" be given to "each shareholder" at least "five days prior to the day named for the meeting." The petitioner also has never disputed that there is no evidence that such written notice of the October 31 meeting was provided to all of Eastern's minority shareholders. The subject bankruptcy petition, therefore, having been authorized by "directors" elected at an unlawful shareholders meeting, was dismissed by Judge VanArtsdalen on that additional ground (App. 1:022-023).

Moreover, even the petitioner has not had the audacity to suggest that the rights of Eastern's minority shareholders can be disregarded simply because they own only a small percentage of Eastern.[10] There can be no question, therefore, not only that this case was properly dismissed both because First Pennsylvania was not a shareholder of Eastern and because it improperly set the date of the special shareholders meeting, but also that this case was properly dismissed because of the absence of timely written notice of the special shareholders meeting to Eastern's minority shareholders.

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10. *See, e.g., Steinberg v. American Bantam Car Co.*, 76 F. Supp. 426, 437 (W.D. Pa. 1948) ("The election of the directors should be orderly and with a full and complete opportunity for a participation of *all* the stockholders") (emphasis added); *Commonwealth ex rel. Claghorn v. Cullen*, 13 Pa. 133, 144 (1850) (minority cannot be deprived of the "opportunity to deliberate, and if possible, to convince their fellows" to vote differently).

V.

THE "NEW" DIRECTORS WERE NOT VALIDLY ELECTED BECAUSE THE PURPOSE OF THE SPECIAL SHAREHOLDERS MEETING WAS NOT DISCLOSED.[11]

Neither the petitioner nor the District Court disputed that in order for the October 31 special shareholders meeting to have been valid, First Pennsylvania must have notified the shareholders of Eastern of the "purpose" of the meeting.[12] First Pennsylvania failed to do so. As disclosed in an October 9, 1980, memorandum produced by First Pennsylvania, the bank called the special shareholders meeting in order to enable it to (i) *put Eastern into bankruptcy* and (ii) *use the bankruptcy proceeding in order to obtain control of State National Bank.*[13] It did not apprise any of Eastern's shareholders of those facts. Necessarily, therefore, First Pennsylvania's actions were invalid on that additional ground.

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11. Of the five independent grounds advanced by Eastern as to why its motion to dismiss should have been granted, this is the sole ground that was not expressly adopted by the District Court.

12. *See, e.g., Bagley v. Reno Oil Co.*, 201 Pa. 78, 83, 50 A. 769 (1902).

13. As detailed in the subject memorandum, which Eastern obtained pursuant to court order, the bank formulated a plan as early as October 9, 1980, to obtain control of Eastern's board, to have the board "approve and authorize a filing by E.B.C. of a petition under Chapter 11," and then to use the bankruptcy proceeding to "[s]eek a reversal of the dilution of E.B.C.'s ownership in S.N.B. to the 64% original level." The shareholders, who would obviously have been interested in First Pennsylvania's plan to take control of State National Bank (Eastern's only remaining asset was its SNB stock, and First Pennsylvania had already established its inability properly to manage even itself), were informed of nothing.

VI.

THE PETITIONER'S ASSERTION THAT BANKRUPTCY COURTS ARE COURTS OF EQUITY IS TOTALLY BESIDE THE POINT.

In its brief, the petitioner points out that bankruptcy courts are courts of equity. That assertion is totally beside the point. The subject Chapter 11 petition was dismissed for jurisdictional reasons — the persons who filed it on behalf of Eastern had no authority to do so under Pennsylvania corporate law.

CONCLUSION

In conclusion, Eastern was never properly put into bankruptcy because the persons who authorized the filing of the bankruptcy petition were not authorized to do so. Moreover, the absence of such authorization was no mere "technicality". If it were, the petitioner, rather that litigating this case all the way to the Supreme Court, would have merely remedied the lack of authorization by holding new elections.

For the reasons stated above, the District Court's decision granting Eastern's motion to dismiss the bankruptcy petition, and the Third Circuit's summary affirmance thereof, were manifestly proper and necessitated nothing more than a straightforward application of Pennsylvania corporate law. There are, therefore, no special or important reasons warranting the granting of a writ of certiorari.

Respectfully submitted,

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